No. 94-560-CFX
Status: GRANTED

Title: First Options of Chicago, Inc., Petitioner
v.
Manuel Kaplan, et ux. and MK Investments, Inc.

Docketed:
September 27, 1994

Court: United States Court of Appeals for the Third Circuit

Counsel for petitioner: Bedell,Stephen P., Holzhauer,James D.

Counsel for respondent: Perelman,Donald L., Rosen,Gary A.

NOTE: Counsel for petr states 3rd respond shld be as above 092794

Entry	Date	Note	Proceedings and Orders
1	Sep 27 1994	G	Petition for writ of certiorari filed.
2	Oct 27 1994		Brief amici curiae of National Futures Association, et al. filed.
3	Oct 27 1994		Brief amici curiae of Philadelphia Stock Exchange, Inc., et al. filed.
5	Oct 27 1994		Brief of respondents Manuel Kaplan, et ux. in opposition filed.
4	Nov 2 1994		DISTRIBUTED. November 23, 1994 (Page 2)
6	Nov 28 1994		REDISTRIBUTED. December 2, 1994 (Page 15)
7	Dec 5 1994		Petition GRANTED. limited to Questions 1 and 2 presented by the petition.
			**********
10	Jan 18 1995		Brief amici curiae of Philadelphia Stock Exchange, Inc., et al. filed.
8	Jan 19 1995		Joint appendix filed.
9	Jan 19 1995		Brief of petitioner First Options of Chicago, Inc. filed.
11	Jan 19 1995		Brief amici curiae of National Futures Association, et al. filed.
13	Jan 30 1995		SET FOR ARGUMENT WEDNESDAY, MARCH 22, 1995. (2ND CASE).
14	Feb 1 1995		CIRCULATED.
15	Feb 10 1995		Record filed.
		*	Partial record proceedings United States Court of Appeals for the Third Circuit (BOX).
16	Feb 10 1995		Record filed.
		*	Original record proceedings United States District Court for the Eastern District of Pennsylvania.
17	Feb 21 1995	X	Brief of respondent Manuel Kaplan filed.
18	Feb 21 1995		Brief amicus curiae of Securities Industry Association filed.
19	Feb 21 1995	X	Brief of respondent Carol Kaplan filed.
20	Mar 9 1995	X	Reply brief of petitioner filed.
21	Mar 22 1995		ARGUED.

1pp

Supreme Court, U.S.
FILED

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No.

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1994

FIRST OPTIONS OF CHICAGO, INC.,

Petitioner,

v.

MANUEL KAPLAN, CAROL KAPLAN and M.K. INVESTMENTS, INC.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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September 27, 1994

QUESTIONS PRESENTED

1. Whether a court reviewing an arbitration award under the Federal Arbitration Act should apply a *de novo* standard of review or the more deferential standard applied to arbitrators' decisions on the merits when reviewing the arbitrators' decision on arbitrability where the party objecting to arbitral jurisdiction had submitted the issue to the arbitrators for decision, as to which the courts of appeal are in conflict.

2. Whether the United States Courts Of Appeals should apply a *de novo* or an abuse-of-discretion standard of appellate review to a district court's decision denying a petition to vacate an arbitration award and granting a cross-petition to confirm an award, as to which the courts of appeal are in conflict.

3. Whether an "associated person" of a member of the Philadelphia Stock Exchange -- as defined in the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(21) (1988), and the rules of the Exchange -- is subject to the arbitral jurisdiction of the Exchange in a dispute between a member of the Exchange and the "associated person".

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No.

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1994

FIRST OPTIONS OF CHICAGO, INC.,

Petitioner,

v.

MANUEL KAPLAN, CAROL KAPLAN and M.K. INVESTMENTS, INC.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Petitioner, First Options of Chicago, Inc. ("First Options")[1], seeks a writ of certiorari to review an opinion and order of the United States Court of Appeals for the Third Circuit which reversed, in part, an order granted by the district court in favor of First Options.[2] First Options'

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1 Pursuant to Rule 29.1, First Options is 100%-owned by SLK Acquisition Co., a Delaware corporation, which is 100%-owned by SLK Holdings, Inc., a Delaware corporation, which is 100%-owned by Spear, Leeds & Kellogg, a New York limited partnership. All of First Options' subsidiaries are wholly owned.

2 The petitioner, First Options, was a defendant/cross-petitioner and appellee below.

Petition for Rehearing With Suggestion For Rehearing *In Banc* was denied by the Third Circuit.

OPINIONS BELOW

The order denying First Options' Petition for Rehearing With Suggestion For Rehearing *In Banc* was entered by the Third Circuit on June 29, 1994 and is reprinted at Appendix B[3]. The March 31, 1994 opinion of the Third Circuit is reported at 19 F.3d 1503 and is reprinted at App. A. The unpublished decision of the United States District Court for the Eastern District of Pennsylvania (Waldman, D.J.), is reprinted at App. C and may be found at 1992 U.S. Dist. LEXIS 14961 (E.D. Pa. Sept. 25, 1992).

JURISDICTION

The United States Court of Appeals for the Third Circuit issued its opinion on March 31, 1994. App. A. The Court of Appeals denied a timely petition for rehearing with suggestion for rehearing *in banc* on June 29, 1994. App. B. This petition for a writ of certiorari is being docketed in this Court within 90 days from the denial of petition for rehearing. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) (1988).

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3 References to opinions and orders reprinted in the Appendix appear throughout the petition as "App.", followed by the relevant appendix page designations.

STATEMENT OF THE CASE

This case arises from the respondents' action seeking vacatur of an arbitration award and petitioner, First Options of Chicago, Inc.'s ("First Options") cross-action for confirmation of the award. The jurisdiction of the district court was invoked under 28 U.S.C. § 1332 because of diversity of citizenship, First Options being a citizen of Illinois and Delaware and the Respondents all being citizens of Pennsylvania.

First Options is a clearing member of the Philadelphia Stock Exchange ("PHLX" or the "Exchange") and other securities and commodities exchanges. Respondent MK Investments, Inc. ("MKI"), a member of and a market-maker on the Exchange, was a customer of First Options during the Stock Market Crash in October 1987, at which time MKI's trading account suffered substantial losses and incurred a deficit balance of $6,227,188. Respondent Manuel Kaplan ("Mr. Kaplan") is the president and sole shareholder of MKI, and Carol Kaplan ("Mrs. Kaplan") is his wife.[4] Following the Stock Market Crash, First Options and the Respondents executed a work-out agreement dated March 24, 1988 (the "Work-Out Agreement") that addressed the repayment of the loss in MKI's trading account.

First Options filed a Statement of Claim with the Philadelphia Stock Exchange in June 1989 seeking an arbitration award against the Respondents, alleging that

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4 Mr. Kaplan, Mr. Kaplan and MKI will be referred to collectively as "Respondents".

Respondents had breached the Work-Out Agreement. First Options asserted that MKI was liable for the account deficit, that Mr. Kaplan -- the alter ego of MKI -- was liable to the same extent as MKI, and that Mr. and Mrs. Kaplan were liable to First Options for certain tax refunds which were to have been paid over to First Options pursuant to the Work-Out Agreement.

MKI, Mr. Kaplan and Mrs. Kaplan answered First Options' Statement of Claim; Mr. Kaplan and MKI submitted separate counterclaims against First Options, each of which sought an award of $10 million; and, Mr. Kaplan and Mrs. Kaplan submitted objections to the jurisdiction of the Exchange. Subsequently, on February 26, 1990, the Kaplans' counsel withdrew their jurisdictional objections. In December 1991, the Kaplans reasserted their jurisdictional objections in a Motion to Dismiss submitted to the arbitrators. In an order dated January 14, 1992, the arbitrators denied the Kaplans' Motion to Dismiss on jurisdictional grounds. The matter proceeded to an arbitral hearing in May 1992 and, following eight days of hearings, a seven-member arbitration panel entered an award on June 5, 1992 in favor of First Options. This award required Mr. Kaplan and MKI, jointly and severally, to pay First Options $5,662,188 plus interest and required Mr. and Mrs. Kaplan, jointly and severally, to pay First Options $346,342 plus interest.

Respondents timely filed a petition to vacate the arbitrators' award in the United States District Court for the Eastern District of Pennsylvania, and First Options filed a cross-petition seeking confirmation of the award. Among other things, the Kaplans again challenged the arbitrators' jurisdiction over them, asserting that the arbitration panel

"exceeded its powers" in contravention of Section 10(d)(4) of the Federal Arbitration Act, 9 U.S.C. § 10(a)(4). Mr. Kaplan also challenged the arbitrators' determination that he was jointly and severally liable for the award against MKI.

The district court first considered whether the Kaplans had waived their jurisdictional objections, noting that "a party who voluntarily and unreservedly submits an issue to arbitration cannot later maintain that the arbitrators acted without authority to resolve that issue." App. C at 14. The district court summarized the facts relevant to its analysis of whether the Kaplans had waived their jurisdictional objections as follows:

> At a pre-hearing conference on February 26, 1990, the Kaplans voluntarily withdrew jurisdictional objections previously filed, and participated in a discovery conference which was an integral part of the arbitration proceedings. Stip. at ¶ 6; Rec'd. at 130. There was no need or logical reason for the panel [of arbitrators] to address the Kaplans' initial objection to jurisdiction as that objection had been withdrawn. Only in January 1992, two and one-half years after the arbitration process had commenced and two years after withdrawing jurisdictional objections, did the Kaplans file a motion to dismiss for lack of jurisdiction. See Stip., ¶¶ 9, 11. The motion was denied on January 14, 1992. Stip., ¶ 12.

App. C at 15-16. Based upon these facts, the district court concluded that the Kaplans had "clearly indicated their

willingness to submit to the authority of the arbitration panel and forego any jurisdictional objections." App. C at 15.

Having concluded that the Kaplans had waived their jurisdictional objections, the district court noted that the arbitrators' denial of the Kaplans' motion to dismiss the arbitration should be subject to a deferential standard of review. Nonetheless, the district court held that, even under a *de novo* standard, the arbitrators' decision could not be vacated, stating as follows:

> Where a party has waived jurisdictional objections, the court reviews [the arbitrators'] decision to exercise jurisdiction like any other arbitration decision only for a manifest disregard of the law. (Citation omitted.) . . . [T]he court concludes that even under a de novo review, the panel properly exercised jurisdiction. Accordingly, the arbitrators' decision to exercise jurisdiction would not be in manifest disregard of the law.

App. C at 18. On September 25, 1992, the district court denied the petition to vacate, granted First Options' petition to confirm the award and entered judgment on the award.

MKI, Mr. Kaplan and Mrs. Kaplan timely appealed the decision of the district court to the United States Court of Appeals for the Third Circuit. On March 31, 1994, the Court of Appeals filed its Opinion affirming the district court's judgment as to MKI, but reversing the district court's confirmation of the arbitration award against Mr. Kaplan and Mrs. Kaplan on jurisdictional grounds.

The Court of Appeals was presented with two questions concerning standards of review.

First, the Court of Appeals rejected First Options' suggestion that it reconsider its precedents and apply the United States Court of Appeals for the Eleventh Circuit's standard of appellate review for decisions denying a motion to vacate an arbitral award.

> We review a district court's denial of a motion to vacate a commercial arbitration award de novo. [Citing decisions of the United States Courts of Appeals for the Third, Fifth and Seventh Circuits.]
>
> First Options asks us to reconsider these holdings and adopt instead the standard the United States Court of Appeals for the Eleventh Circuit uses. That court reviews decisions denying petitions to vacate arbitration awards for abuse of discretion. See Robbins v. Day, 954 F.2d 679, 681-82 (11th Cir.), cert. denied, ___ U.S. ___, 113 S. Ct. 201, 121 L.Ed.2d 143 (1992). We reject First Options' invitation.

App. A at 13-14.

The Court of Appeals also rejected First Options' assertion that the arbitrators' decision denying the Kaplans' motion to dismiss for lack of jurisdiction should be afforded the same deference as any other decision of the arbitrators. Instead, the Court of Appeals determined that "district courts should independently determine whether an arbitration panel has jurisdiction over the merits of any

particular dispute." App. A at 14 (quoting International Brotherhood of Teamsters, Local 249 v. Western Pennsylvania Motor Carriers Association, 574 F.2d 783, 787 (3d Cir.), cert. denied, 439 U.S. 828 (1978) ("A jurisdictional decision by an arbitrator that he has authority to decide a dispute is subject to a much broader and more rigorous judicial review")).

Applying the *de novo* standard of review to the arbitrators' decision on arbitrability, the Court of Appeals rejected four separate grounds[5] set forth by First Options in support of the arbitrators' jurisdiction and decided that the arbitrators lacked jurisdiction over the Kaplans. Among other things, the Court of Appeals decided that, despite Mr. Kaplans' status as an "associated person" of an Exchange member, he was not subject to the arbitral jurisdiction of the Exchange -- despite Exchange rules to the contrary. App. A at 40.

First Options filed a petition for rehearing with suggestion for rehearing *in banc* that was supported by the Philadelphia Stock Exchange, the Chicago Mercantile Exchange, the Chicago Board of Trade and the National Futures Association as *amici curiæ*. The petition for rehearing noted that the Court's decision to review de novo the arbitrators' decision as to arbitrability was in conflict with decisions of not only the Third Circuit, but also the

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5 First Options argued that Mr. Kaplan was subject to Exchange jurisdiction based upon (1) his status as an associated person of a member at all relevant times, (2) his status as a member when the deficit was incurred, (3) his status as the alter ego of a member at all relevant times, and (4) his execution of the Work-Out Agreement, which contained an arbitration clause in the Subordinated Loan Agreement.

First, Sixth, Eighth and Ninth Circuits. Additionally, the petition for rehearing noted the detrimental impact on dispute resolution in the securities and commodities contexts that would result from the decision limiting the arbitral jurisdiction of the Exchange over "associated persons" of its members. The Court of Appeals for the Third Circuit denied the petition for rehearing with suggestion for rehearing *in banc* on June 29, 1994. App. B.

REASONS FOR GRANTING THE WRIT

Summary Of Argument

The courts of appeals are divided over the appropriate standards of review to be applied under the Federal Arbitration Act (1) by a district court reviewing an arbitrator's decision as to arbitrability and (2) by a court of appeals reviewing a district court's decision granting a petition to confirm an arbitral award or denying a petition to vacate such an award. All courts, however, are in unison in recognizing a national policy favoring arbitration as a form of alternative dispute resolution. The division among the courts of appeals is disruptive of this policy and, more importantly, the standards of review applied by the Third Circuit fail to reflect this policy. Therefore, this Court should grant the writ and resolve the conflicts between the courts of appeals in favor of the more deferential standards of review that are consistent with the policies underlying the Federal Arbitration Act.

Additionally, in a matter of great public importance, this Court should grant certiorari in order to correct that portion of the Court of Appeals' decision which calls into question the arbitral jurisdiction of national securities and

commodities exchanges over disputes between their members and "associated persons" of their members. This decision, if allowed to stand, threatens the usefulness of arbitration in the securities and commodities industry insofar as it limits the jurisdiction of exchanges over the very persons frequently at the heart of otherwise arbitrable disputes; i.e., associated persons. Again, to further the national policy favoring arbitration -- specifically, in securities and commodities disputes -- this Court should grant the writ and clarify the extent of the Exchange's arbitral jurisdiction.

I. There Is A Conflict Among The Circuits Regarding The Standard Of Review To Be Afforded To Arbitrators' Decisions On Arbitral Jurisdiction, Where The Parties Have Presented The Issue Of Arbitrability To The Arbitrators For Determination.

The Court of Appeals' decision to review *de novo* the issue of arbitrability after the arbitrators had considered and ruled upon the Kaplans' motion to dismiss for lack of jurisdiction is in conflict with the decisions of Courts of Appeals for the First,[6] Sixth,[7] Eighth[8] and Ninth[9] Circuits.

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6 Local 369 v. Boston Edison Co., 752 F.2d 1, 3 (1st Cir. 1984) (where the issue of arbitrability was submitted to the arbitrator, the court held that "[d]ecisions on questions expressly committed to the arbitrator for determination are reviewable only to the extent necessary to determine if the arbitral award 'draws its essence from the collective bargaining agreement'."). But see Mobil Oil Corp. v. Local 8-766, 600 F.2d 322, 324-25 (1st Cir. 1979) (where neither party "contest[ed] the principle that the court . . . has an obligation to make its own determination of the arbitrability of the dispute presented," the court held that "[w]hile a court may refer to an arbitrator's discussion on

The Sixth Circuit, for example, holds that "an arbitrator's decision on the issue of arbitrability was not subject to independent judicial review". Vic Wertz Distributing Co. v. Teamsters Local 1038, 898 F.2d 1136, 1139-40 (6th Cir. 1990). In addition to the Third Circuit,[10] the Fourth,[11]

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arbitrability in order to aid its determination, . . . it must make its own independent determination of the threshold issue").

7 Interstate Brands Corp. v. Chauffeurs, Teamsters, Warehousemen & Helpers Local Union No. 135, 909 F.2d 885 (6th Cir. 1990) ("In the present case, as in Vic Wertz, the parties submitted the issue of arbitrability to the arbitrator in the first instance. . . . Thus, the nature of our review of the arbitrator's ruling on arbitrability is different than the situation where the Company refused to arbitrate altogether and the Union brought an action in district court to compel arbitration"), cert. denied, 499 U.S. 905 (1991).

8 Franklin Electric Co. v. International Union, 886 F.2d 188 (8th Cir. 1989) ("Here, although the record is clear it objected to the arbitrator's jurisdiction to decide the arbitrability question, Franklin Electric proceeded to argue the issue to the arbitrator without expressly reserving the issue for initial judicial resolution. By their conduct the parties granted the arbitrator jurisdiction to decide their arbitrability question . . .. Once an issue is properly before the arbitrator, the standard of judicial review for the decision is deferential").

9 George Day Constr. Co. v. United Brotherhood of Carpenters, 722 F.2d 1471, 1476 (9th Cir. 1984) ("where the question of arbitrability is decided by the arbitrator, we are not at liberty to substitute our own view in place of the arbitrator's regardless what our view might be of the correctness of the arbitral decision").

10 But see United Industrial Workers v. Government of the Virgin Islands, V.I., 987 F.2d 162, 167 (3d Cir. 1993) ("If the parties submit the issue of arbitrability to the arbitrator, however, a court is obliged to give the arbitrator's decision regarding the arbitrability of a matter the same deference due an arbitrator's decision on the merits"); GK MGT Inc. v. Local 274, Hotel Employees and Restaurant Employees Union,

Seventh[12] and District of Columbia[13] Circuits have adopted holdings suggesting that an arbitrator's decision regarding arbitrability is not entitled to deference, at least where the party objecting to arbitration jurisdiction expressly reserves the issue for judicial review. Thus, the Circuits are in need of clear guidance from this Court on the appropriate standard of review to be applied to an arbitrator's decision as to arbitrability where the issue has been submitted to the arbitrator for decision.

This Court should grant certiorari in order to resolve the existing conflict between the Circuits in a manner that is consistent with this Court's decisions over the last decade

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AFL-CIO, 930 F.2d 301, 304 (3d Cir. 1991); Pennsylvania Power Co. v. Local Union No. 272, 886 F.2d 46 (3d Cir. 1989); Johnson v. United Food & Comm. Workers, 828 F.2d 961, 964-65 (3d Cir. 1987); and United Steelworkers of America v. American Smelting & Refining Co., 648 F.2d 863 (3d Cir. 1981), cert. denied, 454 U.S. 1031 (1981).

11 Cargill Rice, Inc. v. Empresa Nicaraguense Dealimentos Basicos, 25 F.3d 223, 226 (4th Cir. 1994) (stating, in dictum, that if the arbitrators had interpreted the parties' contract, "their interpretation would not be entitled to deference because it would have involved a determination of their own jurisdiction.").

12 International Association of Machinists v. General Electric Co., 865 F.2d 902, 904 (7th Cir. 1989) ("The arbitrator is not the judge of his own authority -- though to this, as to most, legal generalizations, there is an exception. . . .").

13 Davis v. Chevy Chase Financial Limited, 667 F.2d 160, 166-67 (D.C. Cir. 1981) (holding that, where a party to an arbitration has challenged the arbitrator's authority to decide certain issues, "a reviewing court is obligated to make its own determination of the issue. . . . [but the] court's decision may, of course, be informed by the arbitrator's resolution of the arbitrability question . . ").

that have rejected "the old judicial hostility to arbitration." Rodriguez De Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 480 (1989). The deferential standard of review applied by the First, Sixth, Eighth and Ninth Circuits is more consistent with this Court's recent precedents favoring the resolution of disputes through binding arbitration.[14]

In AT&T Technologies, Inc. v. Communications Workers of America, 475 U.S. 643 (1986), the Supreme Court recognized that "Unless the parties clearly and unmistakably provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator." (Emphasis added.) Id. at 649 (citing, inter alia, United Steelworkers of America v. Warrior & Gulf Nav. Co., 363 U.S. 574, 582-83 (1960)).[15] Moreover,

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14 See Rodriguez De Quijas v. Shearson/American Express, Inc., 490 U.S. 477 (1989); Volt Information Sciences, Inc. v. Board of Trustees, 489 U.S. 468 (1989); Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987); Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985); Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 (1985); Southland Corp. v. Keating, 465 U.S. 1 (1985); Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983). The case principally relied upon by the Court of Appeals to support a *de novo* standard of review, International Brotherhood of Teamsters, was decided by the Third Circuit in 1978, before this series of decisions by the Supreme Court unequivocally recognized arbitration as a judicially favored form of dispute resolution.

15 In United Steelworkers of America v. Warrior & Gulf Nav. Co., the Supreme Court recognized that parties could agree to submit not only questions on the merits of a dispute, but also the question of arbitrability, to the arbitrator. Warrior & Gulf, 363 U.S. at 583 n.7.

the Supreme Court has made abundantly clear that a court must give deference to an arbitrator's decision on a question submitted to the arbitrator by the parties for decision. United Steelworkers v. Enterprise Wheel & Car Corp., 363 U.S. 593, 597 (1960). Thus, the Supreme Court has implicitly acknowledged that when the parties submit the issue of arbitrability to the arbitrator, it is to be decided by the arbitrator, not the Court.

In determining whether a party has clearly and unmistakably submitted the question of arbitrability to the arbitrators, the Ninth Circuit has held that a party to an arbitration, by its conduct, may impliedly submit the question to the arbitrators. George Day Constr. Co., 722 F.2d at 1475. The court in George Day examined the factual basis for finding an implicit submission of the question of arbitrability to the arbitrators, stating as follows:

> In the instant action the employer, by conduct[,] evinced clearly its intent to allow the arbitrator to decide not only the merits of the dispute but also the question of arbitrability. The merits of the dispute along with the question of jurisdiction were fully addressed by the parties during the proceeding and, at its conclusion, the entire controversy was submitted to the arbitrator for decision. Nowhere in the record is there any indication that the employer reserved the question of arbitrability for initial judicial determination in a judicial forum. Under these circumstances, we conclude that the employer impliedly consented to the arbitrator's deciding both the

> question of arbitrability and the merits of the controversy. The employer, by its conduct, clearly demonstrated this purpose.
>
> Had the employer objected to the arbitrator's authority, refused to argue the arbitrability issue before him, and proceeded to the merits of the grievance, then, clearly the arbitrability question would have been preserved for independent judicial scrutiny. The same result could be achieved by making an objection as to jurisdiction and an express reservation of the question on the record. However, where, as here, the objection is raised, the arbitrability issue is argued along with the merits, and the case is submitted to the arbitrator for decision, it becomes readily apparent that the parties have consented to allow the arbitrator to decide the entire controversy, including the question of arbitrability. (Emphasis added.)

George Day Constr. Co., 722 F.2d at 1475.[16]

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16 See also Freight Drivers v. Kingsway Transports, Inc., 1992 WL 281379, at *1 (W.D.N.Y. Aug. 31,1992) ("if a party objects to arbitrability and then proceeds to present such issue to the arbitrator, agreement to proceed before the arbitrator is assumed and, upon review by the court, again the deferential standard of judicial review is employed"); New York Hotel & Motel Trades Council, AFL-CIO v. Hotel Nikko of New York, Inc., 1991 WL 168284, at *4-5 (S.D.N.Y. Aug. 22, 1991) (because the defendant had not refused to argue jurisdiction before the arbitrator and had not moved to stay the arbitration, but had "extensively briefed the jurisdiction question" before the arbitrator, the defendant had waived its right to a de novo review of the arbitrator's jurisdictional determination). Cf. International Association of Machinists v. Fansteel, Inc., 900 F.2d 1005

The Ninth Circuit's analysis in George Day provides a party that objects to arbitral jurisdiction with several logical alternatives to protect against being forced to arbitrate in the absence of an agreement to do so, while at the same time, protecting both the integrity of the arbitral process and the rights of the opposing party. This analysis requires a party objecting to arbitral jurisdiction to choose whether to (1) expressly reserve the issue of arbitrability for *de novo* consideration by the courts or (2) submit the issue of arbitrability to the arbitrators, in which case the courts will grant deference to the arbitrators' decision.

Requiring the objecting party to expressly reserve *de novo* review by a court precludes that party from going through the entire arbitral process risk-free in the hopes of obtaining a favorable award, only to object to the arbitrators' jurisdiction in the event the arbitrator renders an unfavorable award. Such a "heads-I-win, tails-you-lose" approach leads to the potential waste of time, effort and expense by everyone involved and is extremely unfair to the opposing party[17], the arbitrators and the courts, whose powers are being manipulated in such circumstances.

(7th Cir. 1990) (recognizing that a de novo review of a party's jurisdictional objections to arbitrability was appropriate because, at the commencement of the arbitration, that party expressly and explicitly preserved its right to challenge arbitrability after the arbitration), cert. denied, 498 U.S. 851 (1990); Wilkes-Barre Publishing Co. v. Newspaper Guild of Wilkes-Barre, 647 F.2d 372, 382 (3d Cir. 1981) (stating that "[t]he preservation of jurisdictional objections before an arbitrator is permissible" where a party expressly reserved the right to challenge arbitrability in a post-arbitration enforcement proceeding), cert. denied, 454 U.S. 1143 (1982).

17 If a party refuses to submit to arbitration and thereby preserves its objection to arbitrability, the opposing party would have the opportunity to seek a judicial resolution of the issue of arbitration jurisdiction prior to expending the time, effort and expense of a full arbitral proceeding. 9 U.S.C. § 4 (allowing a party to seek a court order compelling arbitration if an opponent refuses to arbitrate).

Mr. and Mrs. Kaplan have manipulated the arbitrators and the courts in the precise manner that the above-cited decisions sought to preclude. The Kaplans submitted their jurisdictional objection to the arbitrators (only after having previously withdrawn those objections); they failed to explicitly preserve their objections for independent judicial review; after the denial of their jurisdictional objections, Mr. Kaplan pursued his $10,000,000 counterclaim to the conclusion of the arbitration process without further objection. Indeed, the Kaplans participated in additional pre-hearing proceedings over the ensuing four months and, thereafter, in an eight-day evidentiary hearing without ever seeking an independent judicial review of the issue of arbitral jurisdiction or even indicating that they intended to do so following the hearing. This hearing required the presence of the parties, their respective counsel, seven arbitrators, the Exchange's Director of Arbitration, and, over the course of the proceedings, nineteen witnesses. After participating fully in this process without expressing their intent -- much less reserving the right -- to seek independent judicial review of the arbitrators' denial of their motion to dismiss (or, for that matter, ever again mentioning their jurisdictional objections before the arbitrators), the Kaplans should not be allowed to reassert their previously rejected jurisdictional objections for *de novo* review by a court.

II. The Circuits Are In Conflict As To Whether A Court of Appeals Should Apply An Abuse-Of-Discretion Standard Or A *De Novo* Standard When Reviewing A District Court's Order Denying A Petition To Vacate, Or Granting A Petition To Confirm, An Arbitration Award.

While acknowledging precedent to the contrary in the Third Circuit, First Options argued that the Third Circuit should apply the United States Court of Appeals for the Eleventh Circuit's standard[18] of appellate review for decisions denying a motion to vacate an arbitral award. The Court of Appeals recognized the split of authority in the Circuits, but refused to adopt the standard applied by the Eleventh Circuit, stating as follows:

> We review a district court's denial of a motion to vacate a commercial arbitration award de novo. Colonial Indem Ins. Co. v. Omaha Indem. Co., 943 F.2d 327 (3d Cir. 1991); Mutual Fire, Marine & Inland Ins. Co. v. Norad Reinsurance Co., 868 F.2d 52, 56 (3d Cir. 1989) ("In reviewing the district court's denial of appellants [sic] motion to vacate the arbitration award, this Court will stand in the shoes of the district court and determine whether appellants were entitled to vacate the

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18 Robbins v. Day, 954 F.2d 679 (11th Cir.), cert. denied sub nom. Robbins v. PaineWebber Inc., 113 S. Ct. 201 (1992). See also Schmidt v. Finberg, 942 F.2d 1571, 1573 (11th Cir. 1991); Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 903 F.2d 1410, 1412 n.2 (11th Cir. 1990); Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378, 1383 (11th Cir. 1988).

> arbitration award pursuant to 9 U.S.C. § 10(d)."); see also RM Perez & Assocs. v. Welch, 960 F.2d 534, 540 (5th Cir. 1992); Moseley, Hallgarten, Estabrook & Weeden v. Ellis, 849 F.2d 264, 267 (7th Cir. 1988).
>
> First Options asks us to reconsider these holdings and adopt instead the standard the United States Court of Appeals for the Eleventh Circuit uses. That court reviews decisions denying petitions to vacate arbitration awards for abuse of discretion. See Robbins v. Day, 954 F.2d 679, 681-82 (11th Cir.), cert. denied, ___ U.S. ___, 113 S. Ct. 201, 121 L.Ed.2d 143 (1992). We reject First Options' invitation.

App. A at 14. The standard of review applied by the Third Circuit, however, fails to give the appropriate level of deference to the decisions of arbitrators.

The Eleventh Circuit's standard of review, on the other hand, appropriately reflects the deference to the arbitral process and the confirmation of arbitral awards embodied in the Federal Arbitration Act and recognized by this Court. This dual standard of review, which defers to decisions that confirm or refuse to vacate arbitral awards but reviews *de novo* decisions that vacate or refuse to confirm such awards, has been explained as follows:

> The standard [of appellate review] most likely to reflect the strong federal policy favoring arbitration is a hybrid standard -- one that requires an appellate court to review confirmation of an award for an abuse of

discretion and to review vacation of an award de novo. Such a standard would . . . require rigorous review of rulings vacating awards but only limited review of rulings confirming awards. It would also mirror the structure of section 15 of the [Federal] Arbitration Act. Section 15 permits interlocutory appeals of orders favoring litigation over arbitration but not vice-versa. More specifically, it permits interlocutory appeals of orders denying motions to compel arbitration and motions to stay litigation pending arbitration but forbids interlocutory appeals of orders granting motions to compel and motions to stay. (Footnotes omitted.)

Stephen H. Kupperman & George C. Freeman, III, Selected Topics in Securities Arbitration, 65 Tulane L.R. 1547, 1605 (1991) (cited in Robbins, 954 F.2d at 682 n.3).

In adopting this "hybrid" standard of review, the Eleventh Circuit clarified the context in which arbitration awards are reviewed and the policies underlying such review, stating as follows:

> By broadly reviewing the grant of a motion to vacate an arbitration award, while narrowly reviewing confirmation of an award, we emphasize the unique context of arbitration, which requires deferential judicial review to promote the primary advantages of arbitration -- speed and finality. *De novo* review of the granting of a motion to vacate enables us to assess whether the district court accorded

> sufficient deference in the first instance, an assessment that a more restrictive appellate review would frustrate. See *Forsythe International*, 915 F.2d at 1020. When a district court denies a motion to vacate an arbitration award, deference is presumed and, therefore, in that context, review under an abuse of discretion is adequate. (Footnote omitted.)

Robbins, 954 F.2d at 682. This Court should grant certiorari and adopt the Eleventh Circuit's standard of review so that the standard which "promote[s] the primary advantages of arbitration" (id.) is applied uniformly throughout the country.

III. In A Matter Of Great Public Importance, The Third Circuit Erroneously Held That, Absent Some Additional Evidence Of Consent To Arbitrate, An "Associated Person" Of An Exchange Member Is Not Compelled To Arbitrate A Dispute With An Exchange Member, Despite An Exchange Rule To The Contrary.

The Court of Appeals determined that, despite the Exchange's rule that associated persons[19] of Exchange members must submit to arbitration of disputes, Mr. Kaplan was not subject to the Exchange's arbitral jurisdiction even

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[19] An "associated person" is "any partner, officer, director, or branch manager of such member [of an exchange] (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such member, or any employee of such member." 15 U.S.C. § 78c(a)(21) (1988).

though he was in fact an associated person of an Exchange member. (App. A at 35-40.) This decision threatens the entire structure -- established by Congress and recognized by the judiciary -- of self-regulation by national securities exchanges and associations, which have been designated as self-regulatory organizations ("SROs"). Indeed, this decision is particularly disruptive to that scheme because most of the individuals who participate in the significant business activity of the SROs are not members of the SRO, but are associated persons of members. Recognizing this, the SRO rules provide for arbitral jurisdiction over not only members, but also over associated persons of such members. This Court must reconsider, and correct, the Court of Appeals' holding as to the Exchange's jurisdiction over Mr. Kaplan as an associated person.

A. The Holding of The Court of Appeals

There is no question that, under both federal statutes and the Exchange rules, Mr. Kaplan was an associated person of MKI -- a member of the Exchange -- at all relevant times. Indeed, the Court of Appeals expressly recognized that Mr. Kaplan was an associated person of MKI, stating as follows:

> First Options is correct in asserting that Mr. Kaplan is an associated person within the meaning of the [Securities and Exchange Act of 1934] and the Exchange's rules, including its rules concerning arbitration. . . . Therefore, Mr. Kaplan is without doubt an "associated person" of MKI. Mr. Kaplan continued to be an associated person of MKI as one of its directors, its president, and its sole shareholder

> after the workout was signed. (Emphasis added.)

(App. A at 35-36.) Section 6 of Philadelphia Stock Exchange Rule 950 clearly requires associated persons, like Mr. Kaplan, to submit disputes with members of the Exchange, like First Options, to arbitration, stating that:

> Any dispute, claim or controversy . . . between and/or among members and/or associated persons . . . arising in connection with the business of such member(s), or in connection with the activities of such associated person(s), shall be arbitrated under these procedures at the instance of:
>
> * * *
>
> (2) a member against a person associated with a member or a person associated with a member against a member . . . (Emphasis added.)

PHLX Rule 950, § 6, Philadelphia Stock Exchange Guide (CCH) ¶ 2950.

The Securities Exchange Act of 1934 ("Securities Exchange Act"), 15 U.S.C. § 78a et seq. -- like the Commodity Exchange Act, 7 U.S.C. § 1 et seq. in connection with the regulation of the commodities industry -- sets forth a comprehensive system for the federal regulation of the securities industry. As part of this system, Congress delegated to the Securities Exchange Commission ("SEC") the responsibility for overseeing the arbitration process at SROs and granted the SEC "expansive power to

ensure the adequacy of the arbitration procedures employed by SROs." Shearson/American Express Inc. v. McMahon, 482 U.S. 220, 233 (1987). See also Walck v. American Stock Exchange, Inc., 687 F.2d 778, 786 (3d Cir. 1982) ("Congress . . . enacted the statutory schema that in its view would best serve its various goals of promoting transactional efficiency, fair dealing and investor protection, and of limiting expensive and ineffective federal intervention"), cert. denied, 461 U.S. 942 (1983). Thus, rules promulgated by SROs, including the arbitration rules of the Exchange, must be approved by the SEC, pursuant to Section 19(b)(1) of the Securities Exchange Act, 15 U.S.C. § 78s(b)(1) (1988). McMahon, 482 U.S. at 233-34. The SEC has approved the Exchange's arbitration rules. Sec. Exch. Act Rel. No. 34-29352, 56 Fed. Reg. 29511 (June 27, 1991).[20]

Notwithstanding the straightforward requirements of the Exchange's SEC-approved arbitration rules, the Court of Appeals engrafted upon the stated provisions of Exchange Rule 950, § 6 an additional requirement of independent consent to arbitrate by the associated person, stating:

> Where, as here, the arbitration involves an obligation the officer has undertaken separately and independently of his acts as an agent of the member that employs him, we believe some evidence of an associated person's consent to arbitrate beyond his or her employment as an agent or executive of a member must appear.

(App. A at 39.)

Essentially, the Court of Appeals disregarded the plain meaning of the Exchange rules and held that Mr. Kaplan's status as an "associated person" of an Exchange member, by itself, was insufficient to subject him to Exchange jurisdiction. This holding fails to reflect the practical reality of Mr. Kaplan's status as the sole shareholder, the president and director of MKI; that is, Mr. Kaplan controlled and directed all of MKI's operation and MKI acted through Mr. Kaplan in its (and his) Exchange-related activities. Even assuming the Court of Appeals correctly limited the Exchange's jurisdiction over associated persons to situations in which the associated person was acting as an agent of the member, First Options' claim against Mr. Kaplan was that he was acting as the agent and alter ego of MKI. Thus, even under the Third Circuit's restrictive view of Exchange jurisdiction, the Exchange had jurisdiction over First Options' claim against Mr. Kaplan.

More importantly, however, the Court of Appeals' restrictive reading of the Exchange rules disregards the Supreme Court's mandate that, when construing ambiguous arbitration agreements (even assuming the Exchange rules can be construed to be ambiguous), courts are to resolve all doubts in favor of arbitrability. Mitsubishi Motors Corp., 473 U.S. at 626; Moses H. Cone Memorial Hosp., 460 U.S. at 24-25. Applying the Supreme Court's guidance in this regard, the Exchange's arbitration rules must be

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[20] The provisions of the Philadelphia Stock Exchange arbitration rules are consistent with rules of other SROs providing for jurisdiction over associated persons. See National Association of Securities Dealers, Inc. Rule 8(a), NASD Manual (CCH) ¶ 3708. See also New York Stock Exchange Rule 600(a), NYSE Guide (CCH) ¶ 2600; Chicago Board Options Exchange Rule 18.1(a), CBOE Guide (CCH) ¶ 2511; Pacific Stock Exchange Rule 12.1(a), PSE Guide (CCH) ¶ 6435.

construed to extend arbitral jurisdiction to associated persons of Exchange members.

B. The Court of Appeals' Holding Misconstrues Applicable Case Law And The Purposes Underlying Exchange-Based Arbitrations Between Members And Associated Persons

The Court of Appeals noted that a number of cases discussing arbitration with associated persons included the additional fact, not present here, that the associated person had executed a Form U-4 ("Uniform Application for Securities and Commodities Industry Representative and/or Agent"), which includes an arbitration clause requiring arbitration of employer/employee disputes. However, not all these cases relied on the existence of a U-4 in deciding the associated person issue.[21] Moreover, First Options has not discovered a single case -- and the Court of Appeals cited no such case -- in which a court has similarly engrafted a requirement that an associated person of an exchange member must independently consent to abide by exchange arbitration rules. To the contrary, at least five courts have required associated persons to arbitrate pursuant to SRO rules without any requirement that such persons had previously executed a Form U-4 or otherwise independently consented to arbitration.[22]

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21 See, e.g., Fleck v. E.F. Hutton Group, Inc., 891 F.2d 1047, 1054 (2d Cir. 1989) (holding that an employee, as an associated person, was required to arbitrate his dispute with a non-member of the New York Stock Exchange under that exchange's rules).

22 Swink & Co. & Hereth, 784 F.2d 866 (8th Cir. 1986); Creative Securities Corp. v. Bear Stearns & Co., 671 F. Supp. 961 (S.D.N.Y. 1987); Goldberg v. Donaldson, Lufkin & Jenrette Sec. Corp., 650 F. Supp. 222 (N.D. Ga. 1986); Brennan v. Stanford, 600 N.E.2d 404 (Ill. App. 1st Dist. 1992); Geldermann, Inc. v. Stathis, 532 N.E.2d 366 (Ill. App. 1st Dist. 1988).

In reaching its conclusion, the Court of Appeals attempted to distinguish Goldberg v. Donaldson, Lufkin & Jenrette Sec. Corp., 650 F. Supp. 222 (N.D. Ga. 1986), on the grounds that "[t]here was no dispute about Goldberg's consent to arbitrate. It was shown by his signature on a U-4 Form." (App. A at 39, citing Goldberg, 650 F. Supp. at 226.) However, the Goldberg decision does not indicate that Mr. Goldberg, an associated person of a member of the National Association of Securities Dealers ("NASD"), signed any U-4 Form or that, even if he had signed a U-4 Form, the court relied in any way on such a form. Instead, the Goldberg court concluded that Goldberg was required to arbitrate on the basis of his status as an associated person of an NASD member and the provisions of the NASD Code of Arbitration Procedure, stating:

> The NASD is a self-regulatory organization within the meaning of the Section 28(b) of the Securities Exchange Act. Thus, its members can agree to settle their disputes by arbitration. There is no requirement that such an arbitration agreement be signed by the party to be charged to be enforceable. Numerous courts have recognized that securities exchange members are contractually bound by the regulations of their organizations, including any arbitration provisions. There is no dispute that Goldberg was "a person associated with a member" at the time this dispute arose. There is no indication he was unaware of the NASD arbitration requirements or that his consent to those

> requirements was obtained fraudulently. Accordingly, the court finds Goldberg and [Donaldson, Lufkin & Jenrette] are parties to a valid arbitration agreement. (Citations omitted.) (emphasis added.)

Goldberg, 650 F. Supp. at 226. Thus, rather than requiring a signed Form U-4, the Goldberg court expressly stated that "[t]here is no requirement that such an arbitration agreement be signed." Id. To the extent that the Goldberg court found that Mr. Goldberg consented to arbitrate, it did so based simply upon his status as an associated person of a NASD member. Id.

The Court of Appeals also attempted to distinguish Swink & Co., 784 F.2d 866 (8th Cir. 1986). (See App. A at 38-39 n.23.) In Swink, a broker/dealer and an associated person of a broker/dealer were required to arbitrate a dispute arising out of the issuance of municipal bonds under the Arbitration Code of the Municipal Securities Rulemaking Board. Id. at 868. The Swink court never discussed -- let alone required -- a signed form or some other indicator of consent independent of the associated person's status as an associated person in order to hold that person subject to the arbitration rules of the self regulatory organization.

The Court of Appeals construed the Swink court's omission of any reference to "independent consent" as somehow consistent with a requirement of "independent consent". First Options suggests that the Swink court did not discuss the need for "independent consent" because there is no such requirement. Simply by becoming an associated person of a member of a self-regulatory agency,

an associated person consents to be subject to the rules of that body, including its rules regarding arbitration. Swink, 784 F.2d 868; Goldberg, 650 F. Supp. at 226.[23]

When Mr. Kaplan became an associated person -- i.e., a director, the president, and the sole shareholder -- of a member of the Exchange, he thereby consented to be bound by the Exchange rules regarding associated persons, including the Exchange's rules regarding arbitration. Mr. Kaplan was intimately involved with every aspect of MKI's operation and activities on the Exchange; indeed, he personified MKI on the Exchange. As such, he was fully aware that the Exchange rules imposed certain obligations on associated persons of members of the Exchange, including the obligation to arbitrate disputes with other members. As both the arbitrators and the District Court found, Mr. Kaplan was subject to the arbitral jurisdiction of the Exchange and he was required to submit to the

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23 See also Fleck, 891 F.2d at 1054; Creative Securities Corp. v. Bear Stearns & Co., 671 F. Supp. 961, 966 & n.8 (S.D.N.Y. 1987) (holding that members and persons associated with members of the NASD were obligated to arbitrate pursuant to the NASD Code of Arbitration Procedure); Brennan v. Stanford, 600 N.E.2d 404, 406 (Ill. App. 1st Dist. 1992) ("It is undisputed that Stanford Securities, Inc. is a member of the NASD and that Brack Stanford is associated with that member entity. Plaintiff, too, was associated with the member. Accordingly, paragraph 3708 of the NASD Code, which specifically extends to disputes involving persons associated with members, is applicable to the circumstances presented here. . . . Based on the foregoing, . . . the NASD had jurisdiction to arbitrate the parties' dispute."), app. denied, 610 N.E.2d 1260 (Ill. 1993); Geldermann, Inc. v. Stathis, 532 N.E.2d 366, 368 (Ill. App. 1st Dist. 1988) (holding that members of the CBOE and associated persons of CBOE members have agreed as a matter of law to be bound by the rules of the CBOE, including the right to request arbitration).

arbitration of this dispute under the auspices of the Exchange.

The Court of Appeals' decision in this regard detracts from the ability of securities and commodities exchanges to fulfill their proper roles as self-regulatory organizations -- a role which can be filled only if the regulator has jurisdiction over all of the persons and entities to be regulated. In order to allow these SROs to fulfill the role envisioned for them by Congress, this Court should grant certiorari and clearly state the rules of these SROs which require associated persons to submit to arbitration of Exchange-related disputes are binding and enforceable.

CONCLUSION

For all the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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September 27, 1994

Filed March 31, 1994

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NO. 92-1814

MANUEL KAPLAN; CAROL KAPLAN;
MK INVESTMENTS, INC.,

Appellants

v.

FIRST OPTIONS OF CHICAGO, INC.,

Appellee

Appeal from the United States District Court
for the Eastern District of Pennsylvania
(D.C. Civil Action 92-00210)

Argued: June 23, 1993

PRESENT: STAPLETON, MANSMANN
and HUTCHINSON, *Circuit Judges*

(Filed March 31, 1994)

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OPINION OF THE COURT

HUTCHINSON, *Circuit Judge*.

Appellants Manuel Kaplan, Carol Kaplan ("Kaplans"), and M.K. Investments, Inc. ("MKI"), appeal an order of the United States District Court for the Eastern District of Pennsylvania. It confirmed an arbitration award arbitrators appointed under the rules of the Philadelphia Stock Exchange ("the Exchange") had entered in favor of appellee First Options of Chicago, Inc. ("First Options").

The Kaplans argue that the arbitration panel lacked jurisdiction over them. First Options says that the Kaplans have waived any jurisdictional objections. Because they raised their objection to arbitral jurisdiction several times during the arbitration proceedings, we hold that the Kaplans have not waived it. We also reject First Options' alternate argument that an agreement MKI signed as part of a "workout," meant to settle a dispute arising out of Mr. Kaplan's activities as a principal of MKI and a former member of the Exchange, evidences the Kaplans' consent to arbitrate and the Kaplans' individual liability for performance of the workout. There was no arbitration clause in the workout document the Kaplans signed.

First Options' argument that Mr. Kaplan's position as an officer of MKI compelled him to arbitrate his obligations under the workout as an "associated person" of a member, MKI, is also rejected. The record does not contain any U-4 Form or other document evidencing Mr. Kaplan's agreement to arbitrate, and the terms of the workout plainly show that he did not agree to submit his personal responsibility for MKI's obligations to arbitration.

In addition, we reject First Options' argument that Mr. Kaplan's former membership in the Exchange subjected him to arbitration under its rules relating to members. The only dispute that arose while Mr. Kaplan was a member was the dispute that led to the workout, not the dispute over the workout's performance that the arbitrators heard.

Finally, we reject First Options' argument that Mr. Kaplan is the alter ego of MKI. The evidence of failure to observe corporate formalities in some distributions MKI made to him is insufficient to show that MKI was a sham that Mr. Kaplan manipulated in fraud of creditors.

We will therefore reverse the district court's order confirming the arbitration award against the Kaplans and remand the case to it with instructions to enter an order granting the Kaplans' request to vacate the arbitrators' award against them as individuals.[1] We will, however, affirm the district court's order confirming the arbitration ward as to MKI.[2]

I. *Factual & Procedural History*

First Options is a "clearing firm" or "clearinghouse" and member of the Exchange. MKI, a Pennsylvania corporation, was an "options market maker"[3] on the Exchange from 1984 through 1989. First Options acted as MKI's clearing firm on the Exchange pursuant to a Market Maker's Agreement between MKI and First Options dated November 15, 1984. The Market Maker's Agreement,

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1 In a separate order, we will deny the Kaplans' motion to strike certain exhibits and appendices from First Options' brief as well as First Options' motion to file a supplemental appendix.

2 See *infra* note 30.

3 An "options market maker" trades options for its own account. A market marker's trading is facilitated by a "clearinghouse." It provides administrative support and risk control services and guarantees a market maker's account to other traders. A clearinghouse is compensated in part by commissions generated by the market maker.

executed by Mr. Kaplan on behalf of MKI, provided in part that "any controversy between [First Options and MKI] arising out of [MKI's] business or this agreement . . . shall be submitted to and determined by arbitration . . . ." Appendix ("App.") at 73. Mr. Kaplan has been the president, a director and the sole shareholder of MKI since 1986. MKI has been a member of the Exchange since 1984. From November 8, 1981, to December 8, 1987, Mr. Kaplan was also a member of the Exchange individually.

On October 19, 1987, corporate equities suffered an unprecedented drop in value. Stocks traded on the New York Stock Exchange, and those traded on regional exchanges, crashed. The Philadelphia Stock Exchange was no exception. Five days before the crash, MKI's trading account had a balance or net equity of approximately $10.5 million. On October 19, 1987, MKI lost over $12 million and its account had a deficit of $2.1 million by the end of the trading day.

As the clearing firm for MKI, First Options guaranteed to the Exchange and the persons with whom MKI traded that all positions in MKI's accounts would be covered. After trading closed on October 19, 1987, First Options was at risk on the $2.1 million deficit in MKI's account.

First Options' agreement with MKI gave it the right to liquidate MKI's positions "whenever in [First Options'] discretion [First Options] deem[ed] it necessary." App. at 72. Therefore, First Options took control of MKI's trading accounts and proceeded to liquidate any remaining positions which, in its opinion, posed significant

unacceptable risks. First Options' liquidation of MKI's positions increased MKI's deficit to $5.1 million.

MKI and First Options had, in the meantime, entered into settlement negotiations about MKI's continued operation. First Options pressed Mr. Kaplan to assume personal liability for MKI's obligations. Mr. Kaplan refused. Instead, he and MKI disputed the size of MKI's deficit and claimed that First Options' mishandling of the liquidation was only increasing the deficit. During these negotiations, Mr. Kaplan and his counsel told First Options that neither MKI nor Mr. Kaplan had any liquid assets to contribute to any settlement or workout beyond MKI's interest in a joint trading account, certain exchange memberships and the 1987 federal income tax refund the Kaplans were anticipating.[4]

Negotiations continued during November and December and there is evidence that the parties reached a "handshake" deal in December. On December 8, 1987, Mr. Kaplan relinquished his membership on the Exchange and negotiations continued. On March 24, 1988, the Kaplans, MKI, and First Options separately executed four documents evidencing an overall method of settling the dispute that had resulted from MKI's October 19, 1987, deficit. They were: (1) a Letter Agreement executed by First Options, MKI, Mr. Kaplan, Mrs. Kaplan, and certain other entities and individuals; (2) a Guaranty executed only by MKI;

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4 The expected refund may have been the result of MKI's problems. MKI was a Subchapter S corporation which passes its own income and losses through to its individual shareholders for inclusion in their individual tax returns.

(3) a Subordinated Loan Agreement executed by First Options, MKI, and a separate entity; and (4) a Subordinated Promissory Note executed by MKI. Only one of these four documents, the Subordinated Loan Agreement, contained an arbitration clause, and only First Options, MKI and the other entity, whose agreement to arbitrate is not material to this case, signed that document.[5] Individually, Mr. and Mrs. Kaplan signed only the Letter Agreement. It did not have an arbitration clause.

Under the terms of the Workout:

- MKI agreed to repay a total of $6,227,188, the full amount of its trading deficits, including the added $3 million incurred while First Options' was liquidating its risky accounts;

- MKI immediately transferred four Exchange memberships to First Options;

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5 The arbitration clause in the Subordinated Loan Agreement provided in relevant part:

> [A]ny controversy arising out of or relating to this [Subordinated Loan] Agreement, the Letter Agreement, the Subordinated Notes or any other document referred to herein or therein or the breach thereof shall be submitted to and settled by arbitration pursuant to the Constitution and Rules of the Exchange. The parties hereto and all who may claim under them shall be conclusively bound by such arbitration.

App. at 108-09.

- MKI and Mr. Kaplan immediately contributed $900,000 to a new Trading Account and MKI resumed trading on the new account in April 1988;

- Mr. Kaplan paid First Options $80,000;

- Mr. and Mrs. Kaplan agreed to remit to First Options their 1987 tax refund, estimated to be at least $300,000, upon its receipt;[6] and

- MKI agreed to split its trading profits with First Options.

First Options agreed to release MKI from any claims First Options might have against it for the disputed debt upon MKI's performance of all its obligations under the workout. First Options also agreed to release Mr. Kaplan, individually, from any claims First Options might have against him beyond those he had undertaken in the workout.

MKI resumed trading in April 1988. On January 16, 1989, before the parties had carried out all the terms of the March 1988 workout, MKI's account suffered another loss of over $1.5 million as a result of a takeover bid for one of

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6 This was Mrs. Kaplan's only obligation under the workout.

the companies in whose stock MKI had a position.[7] In response, First Options ordered Mr. Kaplan to reduce MKI's risk by adjusting some of the positions in MKI's account. Mr. Kaplan did not reduce the risk in MKI's account to First Options' satisfaction.

On January 17, 1989, First Options again took over MKI's accounts and began to liquidate all its positions. First Options also barred MKI and Mr. Kaplan from conducting business on the Exchange and ordered all MKI traders off the trading floor. This second liquidation took about four months. It added $65,000 to the deficit that had been outstanding when the workout began.

After taking control of MKI, First Options demanded an opportunity to inspect MKI's corporate books and the Kaplans' tax returns. It also demanded payment of the $300,000 tax refund the Kaplans had agreed to turn over and contended Mr. Kaplan, along with MKI, was liable for all sums still due from MKI because they were alter egos of each other. The Kaplans refused First Options' demands, asserting that it was again compounding the problem by its ongoing liquidation of MKI's accounts. First Options then declared all sums still due under the workout accelerated and demanded immediate payment of the accelerated debt.

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7 MKI was carrying large "short call" positions in securities of Texas Eastern Corp. These calls go down when the stock rises. On January 15, 1989, a takeover bid for control of Texas Eastern was announced. Its stock rose 50% above its January 14, 1989 closing price. The resulting decline in value of MKI's short calls caused the $1.5 million loss.

Ultimately, First Options submitted the dispute over the workout to the Exchange. It sought: (1) $6,292,421.60 from MKI for breach of contract; (2) $300,000, the amount of the Kaplans' 1987 tax refund, from the Kaplans individually; (3) $6,292,421.60 from Mr. Kaplan on the theory he was individually liable as MKI's controlling person; (4) $6,292,421.60 from Mr. Kaplan as MKI's alter-ego; plus (5) interest, costs, and attorneys' fees against MKI and the Kaplans.[8] MKI and First Options signed a submission agreement, separate and apart from the arbitration provision contained in the Subordinated Loan Agreement, submitting the case to the Exchange for arbitration. Mr. Kaplan and Mrs. Kaplan have never signed any such agreement.

On July 24, 1989, the Kaplans and MKI filed responses denying liability, and Mr. Kaplan and MKI filed counterclaims against First Options, each seeking $10,000,000 from First Options for breach of contract, interference with prospective business opportunities and libel and slander. The Kaplans also submitted written objections to the arbitrators' jurisdiction under the Exchange's arbitration rules. In them, the Kaplans stated, "The Philadelphia Stock Exchange . . . and the Arbitration

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8 Though it claimed a right to recover its damages from either Mr. Kaplan or MKI, First Options would, of course, be entitled to only one recovery of the $6,292,421.60 damages claimed. In addition, it is apparent from the submission that the only issue that affected Mrs. Kaplan was her liability for the $300,000 tax refund under the Letter Agreement. The submission of Mr. Kaplan's liability as a controlling person included possible liability under the Exchange rules relating to "members" and "associated persons."

Committee . . . lack jurisdiction over this matter and the purported claim should be dismissed." App. at 311-12.

On February 26, 1990, not quite two years later, there was a pre-hearing discovery conference. The Kaplans' former counsel participated in it without renewing the objections to the arbitrators' jurisdiction. The Kaplans contend his limited participation in the discovery conference did not waive their objections to jurisdiction. Neither the Kaplans nor First Options submitted any documents to the Exchange that confirmed the Kaplans' withdrawal of their objections to the arbitrators' jurisdiction at the discovery conference or thereafter, and the arbitration panel's February 26, 1990, discovery order did not mention jurisdiction.

For the next twenty-two months, no discovery took place and no motions were filed; nor did the arbitration panel conduct any proceedings or issue any rulings before January 10, 1992. In December 1991, the Kaplans retained new counsel. On January 6, 1992, they filed a motion to dismiss for lack of jurisdiction. They also complained about the arbitrators' failure to rule on the objections they had filed two years earlier and said they were "reiterat[ing] and renew[ing] their objections to the Committee's jurisdiction." App. at 194.

In response to the Kaplan's motion to dismiss for lack of jurisdiction, First Options argued in the alternative that Mr. Kaplan was bound to arbitrate under Exchange rules because he was a member of the Exchange at the time of the October 19, 1987 crash, because he is an associated person of a member, or because he was MKI's alter ego.

The Exchange denied the Kaplans' motion to dismiss for lack of jurisdiction without comment.

Sometime in May 1992, the matter finally proceeded to arbitration and, after eight days of hearings, the seven-member arbitration panel voted five to two to pierce the corporate veil and, on June 5, 1992, entered an award for $5,662,188.00 plus interest in favor of First Options and against Mr. Kaplan and MKI jointly and severally. The panel also ordered the Kaplans, jointly and severally, to remit their 1987 tax refund, $346,342.00, plus interest. Finally, it found for First Options on Mr. Kaplan's and MKI's counterclaims.

The Kaplans and MKI filed a petition to vacate the award in the district court and First Options filed a cross-petition for its confirmation. In an order accompanied by a memorandum opinion dated September 25, 1992, the district court confirmed the award. It held that Mr. and Mrs. Kaplan had consented to Exchange arbitration under the arbitration clause in the Subordinated Loan Agreement even though neither had ever signed that particular document. Alternately, the court held that the Kaplans' former counsel's participation in the 1990 discovery conference had waived their jurisdictional objections.

The district court then went on to affirm the arbitrators' decision to pierce the corporate veil on the merits. It also held, without explanation, Mr. Kaplans' release from individual liability was conditioned upon performance of the workout and that the release was ineffective because the workout had not been fully

performed,[9] but explained that the corporate veil would have been properly pierced even if the workout's provision released the Kaplans as individuals. The Kaplans and MKI filed a timely notice of appeal.[10]

II. *Jurisdiction & Standard of Review*

The district court had subject matter jurisdiction over this action to confirm or vacate the arbitration award under 28 U.S.C.A. § 1332 (West 1993) and 9 U.S.C.A. §§ 9, 10 (West 1970 & Supp. 1993). We have appellate jurisdiction over MKI's and the Kaplans' appeal from the final judgment of the district court confirming the award under 28 U.S.C.A. § 1291 (West 1993).

We review a district court's denial of a motion to vacate a commercial arbitration award *de novo*. *Colonial Penn. Ins. Co. v. Omaha Indem. Co.*, 943 F.2d 327, 331 (3d Cir. 1991); *Mutual Fire, Marine & Inland Ins. Co. v. Norad Reinsurance Co.*, 868 F.2d 52, 56 (3d Cir. 1989) ("In reviewing the district court's denial of appellants [sic] motion to vacate the arbitration award, this Court will stand in the shoes of the district court and determine whether appellants were entitled to vacate the arbitration award pursuant to 9 U.S.C. § 10(d)."); *see also RM Perez & Assocs. v. Welch*, 960 F.2d 534, 540 (5th Cir. 1992);

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9 In deciding the issue of the arbitrators' jurisdiction, we do not reach the merits of whether the parties intended to release Mr. Kaplan unconditionally. See *infra* note 16.

10 Mr. Kaplan filed a petition in bankruptcy on February 2, 1993. Neither Mrs. Kaplan nor MKI are in bankruptcy. On March 11, 1993, the bankruptcy court entered an order modifying the automatic stay to permit this appeal to go forward as to Mr. Kaplan.

Moseley, Hallgarten, Estabrook & Weeden v. Ellis, 849 F.2d 264, 267 (7th Cir. 1988).

First Options asks us to reconsider these holdings and adopt instead the standard the United States Court of Appeals for the Eleventh Circuit uses. That court reviews decisions denying petitions to vacate arbitration awards for abuse of discretion. *See Robbins v. Day*, 954 F.2d 679, 681-82 (11th Cir.), *cert. denied*, 113 S. Ct. 201 (1992). We reject First Options' invitation. Even if this panel were to look favorably on the new standard it suggests, we could not adopt it. *See* Third Circuit Internal Operating Procedure 9.1 (1993) ("[N]o subsequent panel overrules the holding in a published opinion of a previous panel."). Only the Court *in banc* has power to change our present standard of review. *See* Third Circuit Internal Operating Procedures 9.1 (1993).

This Court has also held the district courts should independently decide whether and arbitration panel has jurisdiction over the merits of any particular dispute. In *International Brotherhood of Teamsters, Local 249 v. Western Pennsylvania Motor Carriers Association*, 574 F.2d 783 (3d Cir.), *cert. denied*, 439 U.S. 828 (1978), we stated:

> [W]hether the arbitrator has jurisdiction over a particular dispute -- i.e. whether the controversy is arbitrable -- is a question for the court to decide. A jurisdictional decision by an arbitrator that he has authority to decide a dispute is subject to a much broader and more rigorous judicial review. *Bieski v.*

> *Eastern Automotive Forwarding Co.*, [396 F.2d 32 (3d Cir. 1968)]. As we said in *Bieski*:
>
> > If, however, the private decision complained of is a "jurisdictional" one -- that a certain dispute will not be considered on its merits by the private decision-marker -- then the court is a proper forum to review this decision on the basis of its analysis of the contract entered into by the parties.

Id. at 787 (quoting *Bieski*, 396 F.2d at 38) (citations omitted).

We will exercise plenary review over the district court's determination that the arbitration panel had jurisdiction over the Kaplans insofar as it turns on questions of law. *See Mellon Bank v. Farino*, 960 F.2d 1217, 1221 (3d Cir. 1992). To the extent that the district court's determination of arbitral jurisdiction turns on findings of fact, however, our scope of review will be limited to whether those findings are clearly erroneous.

III. *The Parties' Contentions*

The Kaplans argue that the Exchange's Arbitration Panel lacked jurisdiction over them because they never consented to jurisdiction either in the course of the arbitration proceedings or under the Letter Agreement, the only workout document they signed. First Options, on the

other hand, argues that the Kaplans waived any objection to the arbitrators' jurisdiction by voluntarily submitting the dispute to arbitration and withdrawing their objection to arbitral jurisdiction at the discovery conference. The Kaplans responded before the arbitration panel, the district court and now here that they had withdrawn the objection only for purposes of their participation in a discovery conference and participation in that limited way is not a waiver of their objection to the arbitrator's jurisdiction.

First Options also argues that this record establishes the Kaplans' consent to arbitration even if they did not waive their objection to jurisdiction. In support, it advances three alternate theories. Only the first applies to Mrs. Kaplan. They are: (1) the arbitration clause in the Subordinated Loan Agreement, one of the four documents embodying the workout, subjects the Kaplans to arbitration even though they did not sign it because the four documents refer to each other and must be read together as one agreement under general principles of contract law; (2) because Mr. Kaplan was a "member" of the Exchange at the time some of the underlying incidents occurred that led to the dispute which was the subject of the workout he consented to arbitral jurisdiction under the bylaws and rules of the Exchange requiring its "members" to arbitrate; and (3) Mr. Kaplan, as President of MKI, impliedly consented to arbitral jurisdiction under the bylaws and rules of the Exchange requiring an "associated person" of a member to arbitrate. Finally, First Options contends that Mr. Kaplan was an alter ego of MKI and therefore MKI's consent to arbitrate binds him. We will discuss each of these arguments in turn, beginning with waiver.

IV. *Waiver of Objection to Arbitral Jurisdiction*

As one alternate basis for its conclusion that the arbitrators had jurisdiction over the Kaplans, the district court held their former counsel's participation in the 1990 discovery conference waived their objection to the arbitrators' jurisdiction.

A party does not have to try to enjoin or stay an arbitration proceeding in order to preserve its objection to jurisdiction. *See Pennsylvania Power Co. v. Local Union 272 of the Int'l Bhd. of Elec. Workers*, 886 F.2d 46, 50 (3d Cir. 1989); *Local 719, Am. Bakery and Confectionery Workers v. National Biscuit Co.*, 378 F.2d 918, 921-22 (3d Cir. 1967); *see also Avis Rent-A-Car Sys., Inc. v. Garage Employees Union, Local 272*, 791 F.2d 22, 26 (2d Cir. 1986) (citing *National Biscuit* for proposition that party does not have to seek stay of arbitration to preserve jurisdictional objection). Federal courts encourage participation in arbitration. Requiring parties to refuse to participate in order to challenge arbitral jurisdiction would not advance this goal.

A jurisdictional objection, once stated, remains preserved for judicial review absent a clear and unequivocal waiver. *See Pennsylvania Power Co.*, 886 F.2d at 50 (only where party has "clearly indicate[d] his willingness to forego judicial review" will court find waiver of jurisdictional objection) (quoting *National Biscuit*, 378 F.2d at 921-22). Therefore, where a party objects to arbitrability but nevertheless voluntarily participates in the arbitration proceedings, waiver of the challenge to arbitral jurisdiction will not be inferred. *Id.* In *Pennsylvania*

Power Co., Penn Power had objected to the arbitrability of an issue in its answer to a grievance before the arbitrator, the district court and the court of appeals. *Id.* In *International Brotherhood of Teamsters*, in contrast, both the Union and the Association signed a submission form specifying the issues that could be submitted to arbitration. This Court nevertheless held "the fact that the Union disputed [the arbitrators'] jurisdiction and argued the merits before [the arbitrators] does not constitute a waiver of its jurisdictional objections." *International Bhd. of Teamsters*, 574 F.2d at 786 n.2 (citing *National Biscuit*, 378 F.2d at 921).

The Kaplans refused to sign any submission form. They asserted their objection to jurisdiction at the beginning of the arbitration proceedings. They reasserted it on the record before the arbitrators. Even if their former counsel withdrew the objections from consideration in order to participate in the discovery conference, neither that withdrawal or its scope is docketed or expressly noted in the arbitration record. Later, the Kaplans reasserted their objection in a motion to dismiss for lack of jurisdiction they filed in 1992, when the arbitration proceedings resumed. During the first two years between the 1990 discovery conference and the Kaplans' reasserting of their objection, the case was dormant, without discovery, hearing, motion or ruling.

In January 1992, the arbitration panel denied the Kaplans' motion to dismiss for lack of jurisdiction without stating why. When the Kaplans spoke with the Exchange's Director of Arbitration about the motion, she said only that

the denial was consistent with the Exchange Arbitration Panel's interpretation of jurisdiction. She did not mention waiver.

The district court initially thought the Kaplans' intentions concerning their objection to the arbitrators' jurisdiction were "at least somewhat ambiguous" when they chose to proceed with the 1990 discovery conference. App. at 627. It ultimately decided, however, that they had "clearly indicated their willingness to submit to the authority of the arbitration panel and forego any jurisdictional objections."[11] Memorandum Opinion ("Mem. Op.") at 13 (citing *Yorkaire, Inc. v. Sheet Metal Workers Int'l Assoc. Local Union No. 19*, 758 F. Supp. 248, 253 (E.D. Pa. 1990), *aff'd mem.*, 931 F.2d 53 (3d Cir. 1991) (table)). In *Yorkaire*, the court held that an employer's objections to jurisdiction were waived once it had submitted to arbitration. *Yorkaire*, 758 F. Supp. at 255. There, the district court distinguished *Pennsylvania Power Co.* and *International Brotherhood of Teamsters* because the parties in those cases had persistently reiterated their objections. Mem. Op. at 11-14, n.7.

Yorkaire is materially different from this case, and the district court's reliance on it is misplaced.[12] In *Yorkaire*,

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[11] If this determination is treated as a finding of fact, it is clearly erroneous because the evidence does not support it if the proper standard of "clear and unequivocal waiver" is applied. If it is treated as the application of an incorrect legal standard, our review is plenary. Either way, it cannot stand.

[12] Our affirmance of the district court in *Yorkaire* without opinion is, of course, not precedential. *See Galgay v. Gil-Pre Corp.*, 864 F.2d

the employer belatedly argued that the substance of a union grievance was not a matter over which the arbitration panel had jurisdiction. Despite numerous earlier opportunities to do so, the employer did not contest the panel's jurisdiction to determine what disputes it could hear until after the panel decided the case adversely to it. *Yorkaire*, 758 F. Supp. at 253-54. In *Yorkaire*, the record also showed the employer had initially agreed to submit the question of jurisdiction to the arbitration panel itself. *Id.* at 253. The district court held that a challenge belatedly raised after an adverse ruling, coupled with an express submission of the issue of jurisdiction to the arbitration panel, compelled a finding of waiver. *Id.* at 255; *cf. Bergquist Co. v. Sunroc Corp.*, 777 F. Supp. 1236, 1251 (E.D. Pa. 1991) ("at some point it would [be] unfair . . . to allow [a party that was asserting an objection] to continue in the arbitration process, await an unfavorable decision, and then challenge the arbitration."). The Kaplans have not waited until an adverse decision to assert their objections. They have not clearly and unequivocally consented to arbitration.

This conclusion is supported by *International Brotherhood of Teamsters*. There, the parties had actually signed submission forms yet we held they had not waived their objections to the arbitrators' jurisdiction. *International Bhd. of Teamsters*, 574 F.2d at 786 n.2, 788. Here, the Kaplans reasserted their jurisdictional objection before commencement of the arbitration proceedings and

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1018, 1021 (3d Cir. 1988). Our election to distinguish it, rather than to consider the validity of its rationale, does not indicate we approve or disapprove it.

again, two years later, before the panel heard any evidence, as soon as activity in the case had resumed. The Kaplans did not waive their objections. They reasserted them regularly during the arbitration proceeding. Repeated objection was not required while the case lay dormant. Their participation in the 1990 discovery conference did not waive their objections to the arbitrators' jurisdiction. We cannot say that this act "clearly indicated [their] willingness to forego judicial review." *Pennsylvania Power Co.*, 886 F.2d at 50.

Likewise, Mr. Kaplan's filing of a counterclaim against First Options in the arbitration does not waive his objection to the arbitrators' jurisdiction. We believe filing a counterclaim does not waive an objection to jurisdiction. *Bayou Steel Corp. v. M/V Amstelvoorn*, 809 F.2d 1147, 1149 (5th Cir. 1987); *In re Arthur Treacher's Franchisee Litig.*, 92 F.R.D. 398, 413 (E.D. Pa. 1981); *cf. Neifeld v. Steinberg*, 438 F.2d 423, 431 n.17 (3d Cir. 1971) (dicta). We think Mr. Kaplan had a right, without waiving his objection to the arbitrators' jurisdiction, to file a counterclaim to protect himself against the possibility that the arbitrators could rule against him on the merits of First Options' claims. The counterclaim is not a clear or manifest expression of his "willingness to forego judicial review." *Pennsylvania Power Co.*, 886 F.2d at 50.

The district court erred in holding that the Kaplans had waived their jurisdictional objection. Therefore, we turn to First Options' other arguments in support of the Exchange Arbitration Panel's jurisdiction over the Kaplans.

V. *Consent*

Arbitration is fundamentally a creature of contract. *See, e.g., United Steelworkers v. Warrior and Gulf Navigation Co.*, 363 U.S. 574, 582 (1960). The Supreme Court has stated: "arbitrators derive their authority to resolve disputes only because the parties have agreed in advance to submit such grievances to arbitration." *AT&T Techs., Inc. v. Communications Workers*, 475 U.S. 643, 648-49 (1986) (citations omitted). The Federal Arbitration Act makes written agreements to arbitrate "valid, irrevocable, and enforceable" on the same terms as other contracts. 9 U.S.C.A. §2 (West 1970). There must be evidence sufficient to establish the parties' consent to arbitration. "As a matter of contract, no party can be forced to arbitrate unless that party has entered into an agreement to do so." *PaineWebber Inc. v. Hartmann*, 921 F.2d 507, 511 (3d Cir. 1990). That agreement must be "express" and "unequivocal." *Par-Knit Mills, Inc. v. Stockbridge Fabrics Co.*, 636 F.2d 51, 54 (3d Cir. 1980). On the other hand, doubts about the intended scope of an agreement to arbitrate are resolved in favor of arbitration. *See, e.g., Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).

An arbitrator's decision on the merits will be affirmed as long as it "draws its essence" from the contract. *Pennsylvania Power Co.*, 886 F.2d at 48; *see also Par-Knit*, 636 F.2d at 54. An arbitrator's decision to assert jurisdiction over objection is, however, subject "to a much broader and more rigorous judicial review" than an arbitral decision on the merits. Because it is "a question for the

court to decide," it is subject to *de novo* judicial review. *International Bhd. of Teamsters*, 574 F.2d at 787.[13]

First Options makes three separate contentions in support of its argument that the Kaplans, or at least Mr. Kaplan, as a matter of contract consented to the jurisdiction of the arbitrators. They are:

> (1) the arbitration clause in the Subordinated Loan Agreement covers the Kaplans even though they did not sign it because it is an integral part of the four document package that makes up the workout the parties hoped would solve the problems arising out of MKI's October 19, 1987 deficit;

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13 *Pennsylvania Power Co.* is not to the contrary. Our statement there "[i]n considering the propriety of the arbitrator's decision on arbitrability, however, our review is subject to the same highly deferential standard we employ in reviewing arbitrators' rulings on the merits," *Pennsylvania Power Co.*, 886 F.2d at 48, must be read in light of the general understanding that jurisdiction is a question for the courts and our application of that principle in *International Brotherhood of Teamsters*. Moreover, in *Pennsylvania Power Co.* we recognized that a party with a jurisdictional objection should not be punished merely because that party proceeded with arbitration instead of seeking a stay and immediate judicial review. *Id.* at 50. *International Brotherhood of Teamsters* sets forth clearly and persuasively the reasons that led this Court to review independently timely jurisdictional objections despite the fact that the arbitrators had also considered them. If *Pennsylvania Power Co.* were read to create a different standard, it would be in conflict with our earlier holding in *International Brotherhood of Teamsters*. *Cf.* Third Circuit Internal Operating Procedure 9.1 (1993) ("[N]o subsequent panel overrules the holding in a published opinion of a previous panel.").

(2) Mr. Kaplan consented to arbitration under the Exchange rules because he continued to be an "associated person" of MKI, a continuing member of the Exchange throughout the abortive workout; and

(3) Mr. Kaplan consented to arbitration under the Exchange rules because he was a "member" of the Exchange when the October 19, 1987 dispute arose.

The district court considered only the first of the three, but in the end all three fail to come to grips with one significant set of material facts about which there is no genuine dispute. The record shows that from October 19, 1987 on, Mr. Kaplan persistently refused to take individual responsibility for MKI's obligations to First Options. There were negotiations from then until March 1988. During them, he offered to make some limited contributions to help eliminate the deficit MKI had incurred in the October 19, 1987 crash. That offer was accepted by First Options in March 1988 and its acceptance was formally embodied in the workout documents. These documents limited the Kaplans' obligations to the contribution of certain fixed sums and contained no promise to arbitrate. Thus, though we will separately consider all three of First Options' variations on the theme of consent, the common denominator which applies to all is the absence of any agreement to arbitrate in the only workout document the Kaplans signed as individuals.

A. *The Arbitration Clause in the Subordinated Loan Agreement As Evidence of Consent*[14]

We begin with the argument in support of arbitration on a contract theory that the district court did consider. Did the arbitration clause in the Subordinated Loan Agreement MKI signed bind the Kaplans though they did not sign it? The district court said yes.

The workout had four documents. Only one, the Subordinated Loan Agreement, has an arbitration clause. MKI, not the Kaplans, signed the Subordinated Loan Agreement. First Options argues, however, that the arbitration clause in the Subordinated Loan Agreement nevertheless applies to the Kaplans. It says the four workout documents must be read together because they are all inextricably tied together as part of one transaction. It relies on the case of *Hagerman v. Schulte*, 181 N.E. 677 (Ill. 1932). In *Hagerman*, the court stated:

> Where two or more contracts are part of the same transaction and relate to the same subject-matter, are known to the parties, and are delivered at the same time to accomplish an agreed purpose, such contracts must be

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14 The Market-Maker Agreement with First Options which Mr. Kaplan had executed on behalf of MKI also has an arbitration clause providing "any controversy between [First Options and MKI] arising out of [MKI's] business or this agreement . . . shall be submitted to and determined by arbitration." App. at 73. Neither Mr. Kaplan nor Mrs. Kaplan were parties to the Market-Maker Agreement.

> construed together as parts of the same transaction; and this is so even though the contracts are not executed between the same parties.

Id. at 680. The four documents embodying the workout were all executed on March 24, 1988, for the same overall purpose. Therefore we agree with First Options that they should be construed together in accord with the unobjectionable general principle stated in *Hagerman*. On the other hand, we do not think *Hagerman* supports the proposition that an arbitration clause in a document signed by one party who has generally guaranteed performance of all the obligations other persons have individually undertaken binds those persons who have not signed the document that has the arbitration clause.

The circumstances of this case plainly negate the Kaplans' consent to arbitrate their individual responsibility for MKI's obligations. In the document they signed, they undertook only limited and precisely defined obligations. They eschewed any general responsibility for MKI's obligations. They did not sign any documents that stated they would arbitrate their individual liability under the workout. They have always contended they had no individual responsibility for any obligations MKI might have to First Options. Only MKI undertook overall responsibility. It did so in the Subordinated Loan Agreement signed only by it. The limited obligations the Kaplans did undertake in the workout document they signed indicates at least their belief that they are not individually and personally responsible for all the

obligations of the workout. Unless both parties are in accord, there is no meeting of the minds from which an agreement could be found.

We think people intend to perform the obligations that are embodied in the words of the formal agreements they sign: no more, no less. The workout, read as a whole, does not evidence that the Kaplans consent to arbitrate their individual liability for all the obligations MKI assumed in the Subordinated Loan Agreement it signed.

There is no ambiguity about the absence of any consent to arbitrate in the documents the Kaplans signed individually. The Letter Agreement does no more than obligate them to contribute their individual 1987 tax refunds to the workout. Their failure to do so by March 31, 1989, may be a breach of the Letter Agreement and so constitute an "Event of Acceleration" under the Subordinated Loan Agreement MKI signed, but it does not impose on the Kaplans any obligation to arbitrate or any of the other obligations MKI agreed to. Thus, *Hagerman* does not help First Options.

The other cases First Options and the district court rely on are also inapposite. In reaching its decision that "[t]he Letter Agreement and the Subordinated Loan Agreement were executed in tandem, are inextricably intertwined and mutually dependent and must be read as a whole, particularly given the underlying circumstances and the relationships of the parties[,]" Mem. Op. at 11, the district court relied upon *Com-Tech Associates v. Computer*

Associates International, Inc., 753 F. Supp. 1078 (E.D.N.Y. 1990), *aff'd*, 938 F.2d 1574 (2d Cir. 1991).

Com-Tech is distinguishable on much the same basis as *Hagerman*. Com-Tech and Computer Associates had signed a partnership agreement containing an arbitration provision. Computer Associates sought to compel Com-Tech to arbitrate a dispute arising out of a marketing agreement Com-Tech and it had signed along with the partnership agreement. Though the marketing agreement did not have an arbitration clause, activities under the marketing agreement were one of the things the partnership was formed to engage in. Accordingly, the court held the arbitration clause in the partnership agreement Com-Tech had signed covered disputes about transactions under the marketing agreement that were undertaken on the partnership's behalf. *Id.* at 1084.[15]

In the recent case of *Eli Pritzker v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 7 F.3d 1110 (3d Cir. 1993), this Court held on agency principles that a party who did not sign the agreement out of which a dispute arose was nevertheless subject to arbitration under its arbitration clause. In *Pritzker*, the question was whether persons who acted wrongfully on behalf of their principal or without its

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15 On appeal, the United States Court of Appeals for the Second Circuit held Computer Associates had waived its right to avoid arbitration by participating in the arbitration process. Accordingly, it did not address arbitral jurisdiction. *Com-Tech*, 938 F.2d at 1575. Here, as we have demonstrated in Part IV., there is no waiver by the Kaplans.

authority could be compelled to arbitrate under an arbitration agreement the principal had signed. If First Options were still disputing Mr. Kaplan's responsibility for MKI's losses on October 19, 1987, *Pritzker* could be material. That is not the issue before us. Rather, it is the extent of Mr. Kaplan's obligations under the workout. Mr. and Mrs. Kaplan only contributed some of their individual assets to the workout without assuming any overall responsibility for MKI's obligations. Their responsibility is based on contract, not agency.

Our statement "[b]ecause a principal is bound under the terms of a valid arbitration clause, its agents, employees, and representatives are also covered under the terms of such agreements" does to apply here. *Pritzker*, F.3d at 1121 (citing *Arnold v. Arnold Corp. - Printed Communications for Business*, 920 F.2d 1269, 1281-82 (6th Cir. 1990); *Letizia v. Prudential Bache Secs.*, 802 F.2d 1185, 1187-88 (9th Cir. 1986)). *Arnold* and *Letizia* were also decided on agency principles. *See Arnold*, 920 F.2d at 1281-82; *Letizia*, 802 F.2d at 1187-88. There, individual brokers were entitled to invoke their brokerage firms' right to arbitration in an action against the firm and its agents for fraud and violation of the federal securities laws. Here, the Kaplans' obligation to arbitrate depends on contract, not on agency or their participation with MKI in a wrongful act or statutory tort.

Moreover, in *Pritzker*, the non-signatories and the signatory's interests were co-extensive. That community of interest was material to our decision there. *See Pritzker*, 7 F.3d at 1122. Likewise, in *Isidor Paiewonsky Assocs., Inc.*

v. Sharp Properties, Inc. 998 F.2d 145 (3d Cir. 1993), agents who had not themselves signed the arbitration agreement had interests largely co-extensive with those of their principals. *Sharp Properties*, 998 F.2d at 155. Here, only MKI assumed responsibility for all the obligations of the settlement. The Kaplans have always contended they were not individually liable for MKI's obligations and in the workout that contention was accepted. Thus, the Kaplans' breach could trigger MKI's obligations, but we do not think it could make their individual obligations coextensive with MKI's. The absence of an arbitration clause, or a cross-reference to it in the Subordinated Loan Agreement, in the document the Kaplans signed unambiguously shows their limited contractual obligation to provide funds to MKI was separate from and independent of MKI's obligations, including its express obligation to arbitrate.[16]

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16 The Kaplans argue that differences in language in the release in the workout document they signed individually and language in MKI's release lead to the conclusion that the documents embodying the workout must be construed as treating MKI's corporate obligations separately from the Kaplans' individual obligations. First Options argues the Kaplans' release is conditional on the success of the workout. Mr. Kaplan's release read as follows:

> You [First Options] and your subsidiaries do hereby forever release, discharge, waive and forgive all actions, causes, [sic] of action, suits, accounts, demands, costs, expenses and other liabilities of any kind whatsoever, in law or in equity, which you or your subsidiaries may now have, or which you or your subsidiaries ever had, or which their respective successors or assigns, hereafter ever may have *against Mr. Kaplan* . . ., for, upon or by reason of any activities relating to the Total Indebtedness . . . *on or at any time prior to the date of the signing of this Agreement; provided, however, you and your subsidiaries do not release Mr. Kaplan or Larry Goldberg from complete performance of the terms of this agreement and other documents contained herein and applicable to them.*

App. at 86 (emphasis added). MKI's release reads as follows:

> Upon termination of this Agreement, the release of or payment in full of the Subordinated Notes and other valuable consideration, receipt and sufficiency of which is hereby acknowledged, you [First Options] and your subsidiaries do hereby forever release, discharge, waive and forgive all manner of actions, . . . damages, claims . . . and other liabilities of any kind whatsoever, in law or in equity, which you or your subsidiaries may now have, or which you or your subsidiaries ever had, . . . against MK . . . for, upon or by reason of any activities relating to the Total Indebtedness, including the payment thereof, in the following accounts. . . .

Id. at 85-86. Those differences may add some support to the Kaplans' argument that the arbitration clause in the workout document MKI signed does not bind them individually, but they are inconclusive. Accordingly, we do not rely on them.

Whether the release is conditional is not material on the arbitrators' jurisdiction over the Kaplans. The fact that is material on the arbitrators' jurisdiction is the absence of any arbitration clause in the agreements the Kaplans signed as opposed to its presence in the Subordinated Loan Agreement only MKI signed. On the merits the question whether the parties intended to release Mr. Kaplan from any liability on the losses MKI suffered October 19, 1987, in return for the contributions he and Mrs. Kaplan made to the workout or instead intended to preserve whatever rights First Options might have against him for his management of MKI if the workout failed could become material.

Arbitration was not among the obligations the Kaplans assumed as part of the workout. Indeed, First Options never argued before the arbitrators that the Kaplans could be compelled to arbitrate on an agency theory. If First Options' argument were accepted, every agent of a party who agrees to arbitration would have to arbitrate individual obligations assumed independently of the contract of agency.

The district court erred in holding the arbitration provision in the Subordinated Loan Agreement, a document the Kaplans did not sign, evidenced the Kaplans' consent to arbitrate their individual liability.[17] Thus, we go on to consider the effect the Exchange's bylaws may have on Mr. Kaplan, an issue the district court did not reach.

B. *The Exchange's Bylaws As Evidence of Consent*

First Options contended before the arbitration panel and the district court that Mr. Kaplan was subject to the arbitrators' jurisdiction under the Exchange's bylaws and rules either as a "member" of the Exchange or as an "associated person" of a member. When the arbitration panel denied the Kaplans' motion to dismiss for lack of jurisdiction and went on to consider the dispute over

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17 Because this was the only potential basis other than waiver for the arbitrators' jurisdiction over Mrs. Kaplan, *see* Brief for Appellees at 23, First Options' remaining arguments do not affect her and therefore the district court's order confirming the arbitration award against her must be vacated.

performance of the workout on its merits, it did not give any rationale for its decision to assume jurisdiction.

After the district court held that the Kaplans had waived their jurisdictional objection and, alternately, that the arbitration panel had jurisdiction over the Kaplans by virtue of the arbitration clause in the Subordinated Loan Agreement, it had no occasion to address First Options' contention that Mr. Kaplan's individual membership in the Exchange before the workout was signed or his continuing service as an officer of MKI thereafter showed his consent to arbitration. First Options, however, continues to press its contentions that these facts evidence consent in this Court and we must consider them.

The Supreme Court has stated the Securities and Exchange Commission has "expansive power to ensure the adequacy of the arbitration procedures employed by [a self-regulating organization]." *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 233 (1987). The National Association of Securities Dealers ("NASD") and other regional exchanges, including the Philadelphia Stock Exchange, are self-regulatory organizations within the meaning of section 28(b) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78bb(b) (West 1981 & Supp. 1993). Its members and their employees can unquestionably agree to arbitrate all disputes arising out of their use of the Exchange's trading facilities. *Creative Sec. Corp. v. Bear Stearns & Co.*, 671 F. Supp. 961, 966 n.7 (S.D.N.Y. 1987), *aff'd*, 847 F.2d 834 (2d Cir. 1988); *Goldberg v. Donaldson, Lufkin & Jenrette Sec. Corp.*, 650 F. Supp. 222, 225-26 (N.D. Ga. 1986).

Nevertheless, "'federal policy alone cannot be enough to extend the application of an arbitration clause far beyond its intended scope.'" *Haviland v. Goldman, Sachs & Co.*, 947 F.2d 601, 605 (2d Cir. 1991) (quoting *McDonnell Douglas Fin. Corp. v. Pennsylvania Power & Light Co.*, 858 F.2d 825, 831 (2d Cir. 1988)), *cert. denied*, 112 S. Ct. 1995 (1992). In order to compel arbitration, we think there should be some evidence of agreement or consent to abide by the Exchange's rules before a member or associated person can be compelled to arbitrate. *See Tullis v. Kohlmeyer & Co.*, 551 F.2d 632, 635-37 (5th Cir. 1977); *Coenen v. R.W. Pressprich & Co.*, 453 F.2d 1209, 1211 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972); *Cullen v. Paine, Webber, Jackson & Curtis, Inc.*, 587 F. Supp. 1520, 1522 (N.D. Ga. 1984); *cf. Gateway Coal Co. v. United Mine Workers*, 414 U.S. 368, 374 (1974) ("No obligation to arbitrate . . . arises solely by operation of law. The law compels a party to submit his grievance to arbitration only if he has contracted to do so.").

With this general principle in mind, we consider First Options' contentions that Mr. Kaplan has agreed to Exchange arbitration because of his status as (1) an "associated person" of MKI or (2) a "member" of the Exchange.

1. *Associated Person*

The Philadelphia Exchange's bylaws and rules do not define "associated person."[18] The Securities and Exchange Act of 1934, the authority for an individual exchange's self-regulating rules, *see* 15 U.S.C.A. §§ 78f(b), 78o-3(b)(8), 78s(g)(1), does. It defines "person associated with a member" or "associated person of a member" as "any partner, officer, director, or branch manager of such member (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such member, or any employee of such member." 15 U.S.C.A. § 78c(a)(21) (West 1981).[19]

First Options is correct in asserting that Mr. Kaplan in an associated person within the meaning of the Act and the

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18 The NASD Bylaws, in contrast, specifically define "person associated with a member" as:

> every sole proprietor, partner, officer, director, or branch manager of any member, or any natural person occupying a similar status or performing similar functions, or any natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by such member, whether or not any such person is registered with [NASD] pursuant to these Bylaws[.]

Tays v. Covenant Life Ins. Co., 964 F.2d 501, 502 (5th Cir. 1992) (quoting NASD By-Laws, Art. I(m)).

19 This argument is encompassed in First Options' and MKI's submission of the issue of Mr. Kaplan's liability as a "controlling person" to the arbitrators.

Exchange's rules, including its rules concerning arbitration. The Philadelphia Exchange bylaws and rules were adopted pursuant to the Securities and Exchange Act. Therefore, Mr. Kaplan is without doubt an "associated person" of MKI. Mr. Kaplan continued to be an associated person of MKI as one of its directors, its president, and its sole shareholder after the workout was signed.

First Options argues the Exchange's adoption of a rule including an arbitration provision is all that is needed to require an associated person to arbitrate. If First Options is right, no separate agreement or other evidence of Mr. Kaplan's consent to arbitrate is necessary.[20] His consent to the Exchange's rules on arbitration can be implied from his position as chief executive of MKI. *See Pearce v. E.F. Hutton Group, Inc.*, 828 F.2d 826, 830 (D.C. Cir. 1987) (phrase "associated person" is "not defined in the NYSE rules, but its use therein is clearly meant to draw on the definition found in the Securities Exchange Act of

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20 Section 1 of Rule 950 of the Philadelphia Stock Exchange Rules, entitled "Matters Eligible for Submission," does not expressly refer to "associated persons." We think though that its reference to "others" includes "associated persons." Section 6, entitled "Required Submissions," does expressly include "associated persons." *Compare* PHLX Rule 950 § 1 (Aug. 1991) *with* PHLX Rule 950 § 6(a). Because Section 1, setting forth "Matters Eligible for Submission," does not expressly state disputes involving associated persons are eligible for submission, it has been argued in other cases that disputes with associated persons are not "eligible" for submission despite Section 6. The United States Court of Appeals for the Fifth Circuit noted the problem but did not need to decide the issue under a similar provision of the NASD Code that explicitly limited eligible disputes to those listed in Section 1. *See Tays*, 964 F.2d at 502-03.

1934, which defines it to mean 'any partner, officer, director or branch manager' of a member firm") (quoting 15 U.S.C.A. § 78c(a)(21)); *see also Haviland,* 947 F.2d at 608 (Walker, J., dissenting) (same).

We do not think Exchange Rule 950 § 6(a)(2) requires Mr. Kaplan to arbitrate the dispute with First Options over the workout absent other evidence that he has individually agreed to submit to arbitration this particular dispute over his continuing individual responsibility for MKI's obligations. The workout documents themselves not only fail to furnish that evidence, they negate his consent to arbitration.[21] Because of the nature of this particular dispute and the terms of the workout documents that govern it, we conclude Mr. Kaplan was not required to arbitrate this matter.

Most of the cases that have considered whether persons associated with members of an exchange must arbitrate a dispute involving the exchange or the use of its facilities have required evidence other than the rule itself to show the associated person's consent to arbitrate. The courts deciding these cases have relied on the associated person's execution of a Uniform Application for Securities and Commodities and Industry Representative and/or Agent ("U-4 Form") or a provision in an exchange membership application to show consent. In the standard U-4 Form, an employee expressly agrees to abide by all the exchange rules and submit disputes involving it or a

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21 *See* Part V.A. *supra*.

member to arbitration.[22] *See, e.g., Haviland,* 947 F.2d at 604 (relying on employee's U-4 Form in exchange member brokerage firm); *Pearce*, 828 F.2d at 830 (looking to U-4 Form of branch office manager in member brokerage firms): *Tullis,* 551 F.2d at 634 n.4 (looking to allied membership application of former partners in exchange member firm in liquidation); *Coenen,* 453 F.2d at 1211-12 (relying on statement in application of officer of NYSE exchange member to be admitted to "allied" membership under NYSE rules); *Cullen*, 587 F. Supp. at 1523 (relying on U-4 Form of general securities representative employee in exchange member firm); *see also Banque de Gestion Privee SIB v. TransOptions, Co.,* No. 92 C 5252, 1993 WL 96453 (N.D. Ill. March 29, 1993) (arbitration not compelled in absence of arbitration clause in partnership agreement, filing of U-4 Form by partners or exchange member's express identification of partners as associated persons in filings with exchange).[23]

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22 The standard U-4 Form provides in part:

> [A]ny controversy between me and any member or member organization or affiliate or subsidiary thereof arising out of my employment or the termination of my employment shall be settled by arbitration at the instance of any such party in accordance with the arbitration procedures prescribed in the Constitution and Rules then obtaining of the New York Stock Exchange, Inc.

Pearce, 828 F.2d at 828 (emphasis omitted). It appears customary to have a prospective employee sign and submit a standard U-4 Form to the Exchange in order to obtain such employment. *See id.*

23 We do note that some cases require an associated person to arbitrate without discussing the need for a U-4 Form or other

Where, as here, the arbitration involves an obligation the officer has undertaken separately and independently of his acts as an agent of the member that employs him, we believe some evidence of an associated person's consent to arbitrate beyond his or her employment as an agent or executive of a member must appear.

First Options' reliance on *Goldberg v. Donaldson, Lufkin & Jenrette Sec. Corp.,* 650 F. Supp. 222 (N.D. Ga. 1986), in support of its argument that Mr. Kaplan is subject to arbitration because he is an associated person of MKI, is misplaced. There was no dispute about Goldberg's consent to arbitrate. It was shown by his signature on a U-4 Form.[24] *Id.* at 226.

The record before us does not have any independent evidence of Mr. Kaplan's agreement to arbitrate the question of his responsibility for MKI's obligations. No U-4 Form nor any other document signed by Mr. Kaplan

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independent evidence of consent. *See, e.g., Swink & Co. v. Hereth,* 784 F.2d 866, 868 (8th Cir. 1986) (requiring arbitration under municipal securities code rules between broker/dealer and its officer because officer was associated person without mention of U-4 Form or other independent evidence of officer's consent to arbitrate). None of them state, however, that additional evidence of consent is not needed. The point is simply not discussed.

24 Goldberg was a plaintiff who objected to arbitration. He did so primarily because he was no longer either a NASD member or an associate of a member once his firm had become defunct. He argued that his dispute did not arise as a broker or dealer but out of his activities as an individual investor who had not agreed to arbitration. *Goldberg,* 650 F. Supp. at 226.

shows he had agreed to arbitrate this particular dispute once he relinquished his own membership on the Exchange in December 1987.

Mr. Kaplan's status as an associated person of MKI did not evidence his individual agreement to assume the broad obligation to arbitrate that MKI expressly undertook when it signed the Subordinated Loan Agreement. Under the circumstances of this case, we reject First Options' argument that we can imply Mr. Kaplan's consent to arbitrate his individual liability for MKI's obligations under the workout from his association with MKI, the only party to the dispute who was still a member when the workout documents were signed.

2. *Member*

First Options argues alternately that Mr. Kaplan's individual membership in the Exchange at the time of the crash that precipitated MKI's problem provides the necessary consent to arbitrate. There was a provision in Mr. Kaplan's membership agreement consenting to the Exchange rules, including its rules on arbitration; but Mr. Kaplan's Exchange membership ended in December 1987, several months before execution of the workout documents. See *Tullis*, 551 F.2d at 636-37; *Coenen*, 453 F.2d at 1211 (membership application requiring signatory to abide by exchange rules shows consent to arbitrate).

First Options says the December 1987 termination of Mr. Kaplan's Exchange membership does not matter. It

argues he is still subject to arbitral jurisdiction under Exchange Rule 950 because the circumstance that caused this dispute, the October 1987 stock market crash, happened when he was a member. First Options relies on a commentary to the applicable version of Rule 950, which was in effect until June 20, 1991. It stated: "For purposes of this Rule, the terms member, member organization and associated person of a member, shall be deemed to encompass those persons who were Exchange members at the time the circumstances occurred which gave rise to the controversy." PHLX Rule 950, Commentary .01. This commentary is consistent with case law holding that the membership which is material is membership at the time the events giving rise to the controversy occur. *Cf. Muh v. Newberger, Loeb & Co.*, 540 F.2d 970, 973 (9th Cir. 1976).

It is a dispute over Mr. Kaplan's performance under the workout that is now before us, or perhaps more specifically a dispute over whether the only obligations which survive the workout are those each of the parties undertook in the separate documents they signed to formalize the workout, rather than the earlier dispute over the deficit in MKI's account which arose as a result of the October 19, 1987 stock market crash. We think the workout documents independently define and limit the obligations Mr. Kaplan and MKI independently assumed. Under them MKI retained all the obligations it had as a result of the October 19, 1987 events. Therefore, the workout document the Kaplans signed negates any intent

on their part to arbitrate their individual responsibility for MKI's obligations.[25]

First Options did not seek arbitration of the original dispute while Mr. Kaplan was still a member of the Exchange. Instead, it agreed to the terms in the workout documents. They did not contain any agreement by Mr. Kaplan to arbitrate the question of his individual liability for MKI's obligations.

Here again, First Options' reliance on *Goldberg*, 650 F. Supp. at 225-26, is misplaced. That case concerned Goldberg's obligation to arbitrate a dispute about events that occurred while he was still a member or an associated person of an exchange member. *Id.* at 226 (citing *O'Neel v. National Assoc. of Sec. Dealers, Inc.*, 667 F.2d 804, 807 (9th Cir. 1982); *Isaacson v. Hayden, Stone Inc.*, 319 F. Supp. 929 (S.D.N.Y. 1970)). The *Goldberg* court did not have to consider the effect of an intervening agreement that defined Goldberg's individual obligations without providing for arbitration. The dispute about Goldberg's activities while he was an active member of the Exchange was uninterrupted. Mr. Kaplan terminated his membership before the workout documents were executed. They contained no agreement to arbitrate. The dispute before us

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[25] We note again that this conclusion does not depend on whether the releases in the workout were conditional upon performance of the parties' individual obligations under the workout. We assume they were, but it does not follow from that condition that any pre-existing obligations were reinstated.

concerns an alleged breach of the workout, not the events that led to it.

First Options cannot turn the clock back to the date of the stock market crash in order to require Mr. Kaplan to submit to arbitration because he was then bound by its rules as an exchange member. Accordingly, we reject First Options' contention that Mr. Kaplan's membership in the Exchange before execution of the workout subjects him to arbitration for breach of the workout document he signed after his membership terminated.

VI. *Mr. Kaplan as an Alter Ego of MKI*

Finally, we consider First Options' argument that Mr. Kaplan was subject to binding arbitration as MKI's alter ego. The arbitrators accepted this contention after it was conceded that they had jurisdiction over MKI. They then resolved the alter ego issue against Mr. Kaplan on its merits. If they did so correctly, they would have jurisdiction to subject Mr. Kaplan to all the obligations MKI assumed in the Subordinated Loan Agreement, including its obligation to arbitrate. *See Interocean Shipping Co. v. National Shipping & Trading Corp.*, 523 F.2d 527, 539 (2d Cir. 1975) ("In an appropriate situation, the corporate veil may be pierced and a party may be held bound to arbitrate as the signatory's alter ego.") (citing *Fisser v. International Bank*, 282 F.2d 231, 233-34 (2d Cir. 1960)), *cert. denied*, 423 U.S. 1054 (1976); *see also Dighello v. Busconi*, 673 F. Supp. 85, 89 (D. Conn. 1987), *aff'd mem.*, 849 F.2d 1467 (2d Cir. 1988). But neither this Court nor the district court is bound by the arbitrators'

determination that Mr. Kaplan was the alter ego of MKI. He is entitled to an independent judicial determination of that issue. *Laborers' Int'l Union v. Foster Wheeler Corp.*, 868 F.2d 573, 575-77 (3d Cir. 1989) (per curiam) (right to independent judicial determination of arbitrator's jurisdiction based on alter ego status); *Sheet Metal Workers Intern. Assoc., Local No. 359 v. Arizona Mechanical & Stainless, Inc.*, 863 F.2d 647, 653 (9th Cir. 1988); *see also International Bhd.*, 574 F.2d at 787.

The district court concluded "[e]ven if [First Options had unconditionally released Mr. Kaplan from any liability for the debt in the Workout Agreement], it would not release MKI from liability for the debt and, on the record adduced, would not preclude a piercing of the corporate veil." Mem. Op. at 27. The district court felt "[i]t cannot be said the arbitration panel's decision to pierce the corporate veil was a decision made in manifest disregard of the law." *Id.* We think the district court erred when it used manifest disregard of the law as the standard for judging the arbitrators' alter ego conclusion.[26] Instead, it should

[26] The district court did not confirm the arbitral award against the Kaplans without giving the parties an opportunity to present additional evidence. The parties agreed arbitral record was sufficient to permit the district court to make any required findings of fact. When the district court affirmed the arbitrators' conclusion that Mr. Kaplan and MKI were alter egos, it did not consider the alter ego theory from the standpoint of arbitral jurisdiction. Having already held that the jurisdiction issue was waived, or alternately that the arbitration provision in the Subordinated Loan Agreement required the Kaplans to arbitrate, it confirmed the arbitrators' alter ego decision on its merits. If it had correctly reached the merits, it would have correctly used manifest disregard as the standard of review. *See Carte Blanche*

have determined the issue *de novo*. Manifest disregard applies when a court reviews the merits of an arbitrators' decision. It does not apply to judicial review of an arbitration panel's conclusion that one person is the alter ego of another for jurisdictional purposes. On those issues, courts review the record independently of the arbitrators. Therefore, we must consider the sufficiency of the evidence to show that MKI and Mr. Kaplan were alter egos under a standard less deferential than manifest disregard.

We begin with the proposition that generally a shareholder is not personally liable to perform corporate obligations. The corporate veil is pierced only when "the corporation was an artifice and a sham to execute illegitimate purposes and [an] abuser of the corporate fiction and immunity that it carries." *Wheeling-Pittsburgh Steel Corp. v. Intersteel, Inc.*, 758 F. Supp. 1054, 1058 (W.D. Pa. 1990) (citing *Zubik v. Zubik*, 384 F.2d 267 (3d Cir. 1967), *cert. denied*, 390 U.S. 988 (1968)). "In deciding whether to pierce the corporate veil, courts are basically concerned with determining if equity requires that the shareholders' traditional insulation from personal

(Singapore) Pte., Ltd. v. Carte Blanche Int'l, Ltd., 888 F.2d 260, 265 (2d Cir. 1989). On the issue of the arbitrators' jurisdiction over Mr. Kaplan, however, it should have considered the record independently. So considered, we conclude that the evidence is insufficient to permit a finding that Mr. Kaplan and MKI were alter egos. Any conclusion to that effect by the district court, even if treated as a finding of fact, would be clearly erroneous if the evidence that Mr. Kaplan ignored corporate formalities and manipulated MKI's affairs to defraud its creditors is legally insufficient to support the alter ego conclusion under our case law on the subject.

liability be disregarded and with ascertaining if the corporate form is a sham, constituting the facade for the operations of the dominant shareholder." *Id.* at 1057 (citing *Carpenter's Health & Welfare Fund v. Kenneth R. Ambrose, Inc.*, 727 F.2d 279 (3d Cir. 1983)).

The alter ego concept is a "tool of equity [that] is appropriately utilized 'when the court must prevent fraud, illegality or injustice, or when recognition of the corporate entity would defeat public policy or shield someone from public liability for a crime.'" *Carpenter's Health & Welfare Fund*, 727 F.2d at 284 (quoting *Publicker Indus., Inc. v. Roman Ceramics Corp.*, 603 F.2d 1065, 1069 (3d Cir. 1979)) (internal quotation omitted). Events that permit the corporate veil to be pierced include:

> "failure to observe corporate formalities, non-payment of dividends, insolvency of the debtor corporation at the time, siphoning of funds of the corporation by the dominant shareholder, non-functioning of other officers or directors, absence of corporate records, and the fact that the corporation is merely a facade for the operations of the dominant stockholder or stockholders."

United States v. Pisani, 646 F.2d 83, 88 (3d Cir. 1981) (quoting *DeWitt Truck Brokers v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 686-87 (4th Cir. 1976)). In addition, courts sometimes consider undercapitalization. *Id.*

Not every disregard of corporate formalities or failure to maintain corporate records justifies piercing the corporate veil. That remedy is available only if it is also shown that a corporation's affairs and personnel were manipulated to such an extent that it became nothing more than a sham used to disguise the alter ego's use of its assets for his own benefit in fraud of its creditors. In short, the evidence must show that the corporation's owners abused the legal separation of a corporation from its owners and used the corporation for illegitimate purposes. *See Zubik*, 384 F.2d at 267.

The testimony the arbitrators heard about Mr. Kaplan's personal use of MKI's corporate funds dealt largely with acts that took place in 1986 and 1987, before execution of the workout.[27] It consisted of:

- a withdrawal of $350,000 from MKI's trading account and a deposit of $361,000 into Mr. Kaplan's own account on the same day

- a check drawn on MKI's trading account that was traceable to Mr. Kaplan's purchase of a house

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27 Kevin McCarthy, an investigating accountant and CPA, provided most of the testimony concerning those transactions. He testified that he reviewed MKI's and Mr. Kaplan's financial information from February 1986 to January 1989, when MKI lost its trading ability, because those were the only years for which such information was readily accessible. Thereafter, there was little activity in MKI's accounts.

- a check for $1.4 million Mr. Kaplan wrote on his own checking account to cover a margin call on MKI for about that amount

- a transfer of $125,000 from MKI's trading account to Mr. Kaplan's personal account on which he then wrote checks totaling $125,000 to pay individual federal and state income taxes

- checks for $611,000 drawn to Mr. Kaplan on MKI's corporate account during the eight weeks that followed the October 19, 1987 crash when MKI appeared to be insolvent

- withdrawals aggregating $4.5 million from MKI's corporate account between February 1986 and January 1989 for Mr. Kaplan's personal use.

See Mem. Op. at 25-26.

Mr. Kaplan argues that withdrawal of some corporate funds for personal use before the workout documents were executed cannot make him liable for MKI's obligations as its alter ego because the workout could not be breached before it was signed. Though we think that argument lends some support to Mr. Kaplan's arguments against liability on an alter ego theory, it is not the whole answer to First Options' alter ego argument.

Neither are *Chicago Florsheim Shoe Store Co. v. Cluett, Peabody & Co.*, 826 F.2d 725, 727-28 (7th Cir.

1987), and *Connors v. Peles*, 724 F. Supp. 1538, 1559-61 (W.D. Pa. 1989), the cases on which First Options primarily relies to support the alter ego theory. They stand only for the general proposition that alter ego status is determined by conduct of the parties that is material to the dispute at hand. They are not controlling on whether Mr. Kaplan's failure to observe some corporate formalities before the present dispute over performance of the workout arose is material to its resolution.

On this record, however, we think Mr. Kaplan's disregard of corporate formalities in distributions he made to himself before execution of the workout may have some relevance to his responsibility for the obligations MKI assumed in the workout including its obligation to arbitrate.

First Options also pointed to some evidence of withdrawals after the workout documents were signed. Thus, it says Mr. Kaplan used a deceptive financing scheme to raise the $500,000 MKI agreed to and did contribute to the workout and that he falsely represented the source of that money. It points to other evidence that it says showed commingling after MKI resumed trading under the terms of the workout. First Options' witness, Mr. Murphy, testified that $100,000 was drawn out of MKI's trading account on December 21, 1988 and deposited into one of Mr. Kaplan's checking accounts that same day. Mr. Murphy went on to say Mr. Kaplan then transferred $100,000 from this checking account into another personal account on December 30, 1988. Then, on January 2, 1989, five checks were drawn on the latter personal account. They totaled

just under $100,000 and were payable to a real estate joint venture in which Mr. Kaplan was interested.

All this must be balanced against the lack of any evidence from which we might infer Mr. Kaplan's general non-compliance with corporate formalities. Testimony before the arbitrators indicated MKI was validly incorporated, it elected officers and directors, it held regular board meetings and prepared minutes, enacted by-laws, issued share certificates, entered into contracts in its own name, filed tax returns in its own name, maintained corporate books and records and had its own corporate checking account.

We have said MKI's argument that pre-workout events are immaterial to this dispute may lose some force on the alter ego theory. We think this is so because of the element of fraud that lies at its core. Fraud is often a basis for setting aside or refusing to enforce an agreement. Thus, if Mr. Kaplan's corporation, MKI, were a sham that he fraudulently manipulated to First Options' detriment, it would deprive him of the limitation of his own obligations that he sought to accomplish through the workout. But if First Options is to rely on a fraud theory, it must swallow the bitter with the sweet. Because alter ego is akin to and has elements of fraud, we think it too must be shown by clear and convincing evidence. That kind of evidence is not present here. *See Carpenter's Health & Welfare Fund*, 727 F.2d at 283. The record does not show Mr. Kaplan had a practice of culling profits from a failing company while creditors' attempts to seek payment were being rebuffed. Before the 1987 crash, MKI was a profitable entity from

which Mr. Kaplan, as sole shareholder, had a right to draw profits. Moreover, this record does not show that corporate formalities were generally ignored. Alter ego status cannot be inferred whenever a shareholder withdraws some monies from a corporation without formally declaring a dividend or executing a note even if one of the withdrawals is made while the corporation is insolvent.[28] If it did, every payment to a stockholder during insolvency would justify piercing the corporate veil.

The most serious act that occurred before the workout is Mr. Kaplan's withdrawal of $611,000 from MKI during the eight weeks following the October 19, 1987 crash. MKI's books show it was indebted to Mr. Kaplan and these distributions were recorded on its books as "repayments of loans due shareholders." There is no evidence, testimonial or otherwise, which indicates the debt was fictitious. Indeed, the record indicates the contrary. It shows Mr. Kaplan had made loans totaling $1.4 million to MKI. Because MKI was apparently insolvent when the $611,000 was paid to Mr. Kaplan, these withdrawals may be voidable or even void as fraudulent conveyances, but we do not think they justify piercing the corporate veil. We think the proponent of an alter ego theory must show more than shown here.

This record does not show that MKI was a "sham" either pre- or post-workout. Instead, it shows that Mr.

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28 A withdrawal during insolvency could be void or voidable as a fraudulent conveyance, but First Options has never relied on that theory.

Kaplan had run a successful business venture until the crash. From it, before and after the crash, he had sometimes withdrawn funds for personal use without observing corporate formalities. With the exception noted, none of these withdrawals appear to have affected MKI's solvency or to have been made when it was insolvent. This record does not clearly and convincingly show that MKI was a sham Mr. Kaplan manipulated in fraud of its creditors.

The district court's finding that MKI was Mr. Kaplan's alter ego does not withstand review when the correct standard of independent judicial review of an arbitration panel's decision on its own jurisdiction is substituted for the incorrect standard of manifest disregard for the evidence that the district court used. Applying the proper standard, we conclude the Exchange did not have jurisdiction over the dispute between Mr. Kaplan and First Options concerning his individual liability to perform all of MKI's obligations, under the workout or otherwise, on a theory that they were alter egos.

The evidence in this record is insufficient to allow First Options to pierce MKI's corporate veil.[29]

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29 We do not imply that the arbitrators exhibited a manifest disregard for the law when they concluded on the merits that Mr. Kaplan and MKI were alter egos. Indeed, we express no opinion whatsoever on that issue. Before reaching it, a court must decide independently whether the arbitrators have jurisdiction.

VII.

The order of the district court confirming the arbitration award against the Kaplans will be reverse. The record will be remanded to the district court with instructions to enter in its place an order vacating the arbitrators' award against the Kaplans. The order confirming the award as to MKI will be affirmed.[30]

Each party shall bear its own costs.

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30 The only argument MKI asserts to vacate the arbitration award against it is the arbitrators' and arbitration process's bias in favor of First Options. It says this made their award fundamentally unfair in violation of 9 U.S.C.A. § 10(a)(2) (West Supp. 1993) *See* Brief for Appellants at 31. MKI alleges fourteen instances of such bias. In order to show "evident partiality," "the challenging party must show 'a reasonable person would have to conclude that the arbitrator was partial' to the other party to the arbitration." *Apperson v. Fleet Carrier Corp.*, 879 F.2d 1344. 1358 (6th Cir. 1989) (quotation omitted), *cert. denied*, 495 U.S. 947 (1990). "Evident partiality" is strong language and requires proof of circumstances "powerfully suggestive of bias." *Merit Ins. Co. v. Leatherby Inc. Co.*, 714 F.2d 673, 681-82 (7th Cir.). *cert. denied*, 464 U.S. 1009 (1933), *mandate modified*, F.2d 943 (7th Cir. 1984). After review of the record, we conclude that the instances MKI cites, taken together, do not show "evident partiality." The district court's order confirming the arbitration award against MKI will be affirmed for the reasons given by the district court.

A True Copy:
Teste:

Clerk of the United States of Court
of Appeals
for the Third Circuit

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 92-1814

MANUEL KAPLAN; CAROL KAPLAN;
MK INVESTMENTS, INC.,
Appellants

v.

FIRST OPTIONS OF CHICAGO, INC.,
Appellee

Appeal from the United States District Court
for the Eastern District of Pennsylvania
(D.C. Civil Action No. 92-00210)

SUR PETITION FOR REHEARING

PRESENT: BECKER, STAPLETON, MANSMANN,
GREENBERG, HUTCHINSON, SCIRICA,
COWEN, NYGAARD, ALITO, ROTH and
LEWIS, Circuit Judges

The petition for rehearing filed by appellee in the above captioned matter having been submitted to the judges who participated in the decision of this court and to all the

other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By the Court,

/s/ William D. Hutchinson
Circuit Judge

DATED: June 29, 1994

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

MANUEL KAPLAN, CAROL KAPLAN and MK INVESTMENTS, INC.,	:	
Petitioners and Cross-Respondents	:	
v.	:	**NO. 92-MC-210**
FIRST OPTIONS OF CHICAGO, INC.,	:	
Respondent and Cross-Petitioner.	:	

MEMORANDUM

WALDMAN, J. **September 25, 1992**

BACKGROUND

Manuel Kaplan, Carol Kaplan and MK Investments, Inc. ("MKI"), collectively, the petitioners, seek to vacate an arbitration award entered against them on June 5, 1992 by the Philadelphia Stock Exchange (the "Exchange"). The award was entered in the amount of $6,008,530, plus accrued interest, in favor of respondent, First Options of Chicago, Inc. ("First Options"). First Options has filed a cross-petition to confirm the award. An opportunity for hearing and argument was provided. The parties agreed that all necessary factual determinations could be made from the voluminous record submitted by them, including a

transcript of the arbitration proceedings. Moreover, the parties have stipulated to virtually all of the pertinent facts.

FACTS

MKI, a Pennsylvania corporation, was an options market maker on the Exchange from the date of its incorporation in 1984 until January 1989. Tr. at 515.[1] MKI was the successor to MK Associates, Ltd. of which Manuel Kaplan had been the general partner. First Options has been MKI's clearinghouse and Manuel Kaplan has cleared through First Options since the early 1980's. Tr. at 25, 515.

Manuel Kaplan is the president of MKI and its sole shareholder since 1986. Five days before the stock market crash of October 19, 1987, MKI's trading account has a net equity of $10.5 million. Rec'd. at 220. On the day of the crash, MKI's trading account was decimated. On October 19, 1987, MKI's net equity was a negative $2.1 million. Id. at 221.

First Options decided that the large risk exposure and debit on the account necessitated its assuming control over the account and it did so. Tr. at 45. First Options proceeded to liquidate all positions held by MKI which

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[1] An options market-maker is an entity which trades options for its own account. The ability of a market maker to conduct trades is facilitated by a so-called "clearinghouse." A clearinghouse provides the market maker with administrative support, risk control services, and guarantees its account to other traders in exchange for commission compensation.

presented significant risks. Id. at 46-47, 50. First Options' actions were partially prompted by Mr. Kaplan's failure to cooperate with them. Id. at 45 (barricaded himself away from First Options' personnel); Id. at 47 (difficulty in communicating with him because he closed himself off from First Options' staff).[2] When the process was completed, the MKI account had a negative balance of about $5.1 million. Rec'd. at 13.

After an extended period of negotiations, the parties reached agreement for a work-out on the debt (the "Work-Out"). The Work-Out consists of four documents: (1) the Letter Agreement; (2) the Guaranty; (3) the Subordinated Loan Agreement; and, (4) the Subordinated Promissory Note. Stip. at ¶ 21. Each document was executed on March 24, 1988. Id. Under the terms of the Work-Out, the parties agreed to the following:

> MKI acknowledged the $5.1 million debt, as well as the $750,000 debt of another entity, and an additional $300,000 for a total indebtedness to First Options of $6,227,188;
>
> Manuel Kaplan paid First Options $80,000;

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[2] It also appears that Mr. Kaplan was uncooperative in the effort to liquidate the MKI account. Rec'd. at 147 (noting that he was unavailable, refused to communicate, was particularly difficult to deal with, and that staff members in the office found him objectionable and threatening).

MKI agreed to transfer ownership of four Exchange memberships to First Options;

a $900,000 Trading Account with First Options was created, $500,000 of which was designated the "MK Allocation" and $400,000 was designated the "FOC Allocation";

Manuel Kaplan and his wife Carol Kaplan agreed to give First Options their 1987 tax refund upon receipt -- an amount specified to be at least $300,000; and,

> MKI would provide First Options with an agreed percentage of its profits.

Rec'd. at 13-20.

The parties also executed releases. Upon satisfaction of its obligations under the Work-Out agreement, MKI would be released from its indebtedness obligations. First Options executed a release in favor of Manuel Kaplan which clearly provided that he was not released "from complete performance of the terms of this Agreement and other documents contained herein and applicable to them." Id. at 24-25.

Pursuant to the provisions of the Work-Out, MKI renewed its trading in April 1988. Tr. at 60. On January

16, 1989, the position of the MKI trading account again suffered a serious loss as a result of a takeover. Id. at 30, 201. First Options, believing MKI's position was precarious, was concerned that no responsive action was taken and about Mr. Kaplan's stability. Id. at 30-33, 201-202.[3] First Options decided to take over the account. Id. at 33, 35, 223. First Options barred MKI and Manuel Kaplan from conducting further business on the premises and ordered all MKI traders off the trading floor. Id. at 34-35; 222. First Options liquidated all positions in the trading account over a period of four months. Id. at 226. The account yielded a final deficit of about $65,000. Id. at 229.

Thereafter, pursuant to the terms of the Work-Out, First Options sent letters to MKI and the Kaplans demanding that MKI open its books and records for inspection and that the Kaplans honor their agreement to turn over their 1987 tax refund. When the Kaplans did not comply, First Options declared an acceleration under the Work-Out and demanded immediate repayment of the entire debt. Rec'd. at 192-95.

In June 1989, about one month later, First Options submitted this matter to the Exchange for arbitration. MKI and Manuel Kaplan counterclaimed for breach of contract, interference with prospective business opportunity and

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3 First Options had set up a meeting with Mr. Kaplan at 8:00 a.m. the following morning. Tr. at 201. He did not show up and First Options was unable to reach him. Id. at 202. When he finally arrived at 11:00 a.m., First Options found his answers unresponsive to their concerns. Id. at 31-33, 203.

defamation. Each sought damages from First Options in the amount of $10 million.

A seven member arbitration panel heard eight days of testimony between May 7 and May 28, 1992. On June 5, 1992, the panel entered the following award:

> (1) against Manuel Kaplan and MKI, jointly and severally, in the amount of $5,662,188.00, plus interest;
>
> (2) against Manuel Kaplan and Carol Kaplan, jointly and severally, in the amount of $346,342.00, plus interest; and,
>
> (3) against Manuel Kaplan and MKI on their counterclaims.

DISCUSSION

The law is well-established that the "court's function in confirming or vacating a commercial [arbitration] award is severely limited." See Mutual Fire, Marine & Inland Ins. Co. v. Norad Reinsurance Co., Ltd., 868 F.2d 52, 56 (3d Cir. 1989). The Federal Arbitration Act ("FAA"), 9 U.S.C. § 1, et seq., generally sets forth the principles governing a district court's authority to confirm or vacate an arbitration award. Title 9 U.S.C. § 9 provides:

> at any time within one year after the [arbitration] award is made any party to the arbitration may apply to the court . . . for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title . . . . [S]uch application may be made to the United States court in and for the district within which such award was made.

Confirmation "is a summary proceeding that merely makes what is already a final arbitration award a judgment of the court." Florasynth, Inc. v. Pickholz, 750 F.2d 171, 176 (2d Cir. 1984) (citing M. Domke, The Law and Practice of Commercial Arbitration, § 37.02 (1968)). See also Air Line Pilots Ass'n Int'l v. Aviation Associates Inc., 955 F.2d 90, 93 (1st Cir. 1992) ("ordinary analysis of motions under Fed. R. Civ. P. 56 is not particularly helpful because the enforcement proceeding is by nature summary."), cert. denied, 112 S. Ct. 3036 (1992); Taylor v. Nelson, 788 F.2d 220, 225 (4th Cir. 1986) ("A confirmation proceeding under 9 U.S.C. § 9 is intended to be summary: confirmation can only be denied if an award has been corrected, vacated, or modified in accordance with the Federal Arbitration Act.").[4] Absent grounds to vacate or modify the award in this case, it must be confirmed.

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[4] An unconfirmed award is not invalid. Indeed, a majority of awards are not confirmed. Pickholz, 750 F.2d at 176. "A party, successful in arbitration, seeks confirmation by a court generally because he fears the losing party will not abide by the award." Id.

A party challenging an award must establish that:

(1) the award was procured by corruption, fraud or undue means;

(2) there was evident partiality or corruption of the arbitrators;

(3) the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy, or any other misbehavior by which the rights of any party have been prejudiced; or,

(4) the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter was not made.

9 U.S.C. § 10(a) (1)-(4).[5]

An award may also be set aside if it results from a decision reached in manifest disregard of law. See Cart Blanche (Singapore) Pte., Ltd. v. Carte Blanche Int'l, Ltd., 888 F.2d 260, 265 (2d Cir. 1989) (manifest disregard of law

[5] Prior to amendment in 1990, these provisions were designated as subsections (a)-(d) and referred to as such in several pertinent pre-amendment court opinions cited herein.

is judicially-created ground for vacating an arbitration award); Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Bobker, 808 F.2d 930, 933-34 (2d Cir. 1986) (same); Sheet Metal Workers Int'l Assoc. v. Kinney Air Conditioning Co., 756 F.2d 742, 746 (9th Cir. 1985) (same).

In support of vacatur, petitioners assert four grounds:

(1) the arbitration panel lacked jurisdiction over the individual parties, Manuel and Carol Kaplan;

(2) the arbitrators were biased in favor of First Options;

(3) the panel's decision reflects manifest disregard of the law;

(4) the award is fundamentally flawed as it was signed only by the Chairperson of the panel.

A. Jurisdiction of the Panel over the Kaplans

Pursuant to 9 U.S.C. § 10(a)(4), petitioners contend that the arbitration panel "exceeded its powers" since Manuel and Carol Kaplan, as individuals, did not agree to arbitrate this dispute with First Options. Generally, courts read § 10(a) (4) quite narrowly. See, e.g., Fahnestock & Co., Inc. v. Waltman, 935 F.2d 512, 515 (2d Cir.) ("We have consistently accorded the narrowest reading to section 10(d) . . . ."), cert. denied, 112 S. Ct. 3801 (1991), and cert.

denied, 112 S. Ct. 1241 (1991); Andros Compania Maritiam v. Marc Rich & Co., A.G., 579 F.2d 691, 703 (2d Cir. 1978) ("We have consistently accorded the narrowest of readings to the Arbitration Act's authorization to vacate awards 'where the arbitrators exceeded their powers.'"). An award may be vacated if the form of the award cannot rationally be derived from the agreement between the parties or from the parties' submissions to the arbitrators. See Norad Reinsurance Co., 868 F.2d at 56. A court reviewing an arbitration award under § 10(a) (4) shall not "sit as the panel did and reexamine the evidence under the guise of determining whether the arbitrators exceeded their powers." Id.[6]

Individual petitioners' contention that the panel exceeded its authority in exercising jurisdiction over them as they did not consent to the arbitration is premised on the absence of their signature on any document containing an arbitration clause.

The Work-out agreement consists of four documents each dated March 24, 1988. Rec'd. at 13-33; 44-50. The documents are (1) the Letter Agreement; (2) the Guaranty; (3) the Subordinated Loan Agreement; and (4) the Subordinated Promissory Note. Only the Subordinated Loan Agreement contains an arbitration provision and the

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[6] Despite interpretations to the contrary, the court notes that the express language of § 10(a) (4) is more applicable to situations where it is merely unclear that a final and definite award was reached. See International Longshoremen's Assoc. v. West Gulf Maritime Assoc., 594 F. Supp. 670, 677 (S.D.N.Y. 1984).

Kaplans, as individuals, signed only the Letter Agreement which obligated them to provide First Options with their personal income tax refund for 1987. Stip. at ¶ 21; Rec'd. at 27, 47.

The court finds persuasive the reasoning in Com-Tech Associates v. Computer Associates Int'l, Inc., 753 F. Supp. 1078 (E.D.N.Y. 1990), aff'd, 938 F.2d 1574 (2d Cir. 1991). In that case, the parties contested whether they were required to arbitrate their dispute. Although they agreed to arbitrate disputes arising under one agreement, the dispute in question arose under another agreement which did not have an arbitration clause. The terms of the arbitration provision in the one agreement were held to encompass the dispute arising under the other agreement. The parties had executed the agreements in question at or about the same time, and the agreement which was silent on arbitration was referred to in the agreement with the arbitration clause. The Court concluded:

> Although the Marketing Agreement itself fails to specifically provide for arbitration, the circumstances of this case, the relationship of the parties and the strong federal policy favoring arbitration compels the Court to conclude that this dispute arising out of the Marketing Agreement is also subject to arbitration . . . . Based on the totality of circumstances, coupled with the strong federal policy favoring

> arbitration, the Court finds that the Partnership Agreement, which governs the rights and obligations of the parties . . . constituted an "umbrella" for both the System and Marketing Agreements, since all three agreements are interrelated and dependent on each other.

Id. at 1084 (citations omitted).

In the instant case, the facts supporting a similar construction of the parties' agreements are even more compelling. The arbitration provision in the Subordinated Loan Agreement, executed the same day as the Letter Agreement, expressly incorporates the Letter Agreement. It states, in pertinent part:

> any controversy arising out of or relating to this Agreement, the Letter Agreement, the Subordinated Notes or any other document referred to herein or therein or the breach thereof shall be submitted to and settled by arbitration pursuant to the Constitution and Rules of the Exchange. The parties hereto and all who may claim under them shall be conclusively bound by such arbitration.

Rec'd. at 47, ¶ 10 (emphasis added).

Further, the Subordinated Loan Agreement states: "this Agreement [the Subordinated Loan Agreement], the

Letter Agreement, the Subordinated Notes, and any documents referred to herein or therein embody the entire agreement between the parties . . . ." Id. at 48, ¶ 14. The Subordinated Loan Agreement also obligates MKI to "pay to FOC [First Options] or its assigns the amount of the Total Indebtedness subject to that certain Letter Agreement dated March 24, 1988 (the "Letter Agreement") from the borrowers and the other parties thereto and FOC, which is incorporated herein and made a part hereof." Id. at 44. The Subordinated Loan Agreement has references to the Letter Agreement throughout. Similarly, the Letter Agreement has numerous references to the Subordinated Loan Agreement. Id. at 13, 14, 15, 17, 21, 27. Indeed, the Letter Agreement provides that the Kaplans' failure to satisfy timely their personal obligation could constitute an "Event of Acceleration." Id. at 15. An "Event of Acceleration," is not defined in the Letter Agreement but is defined in the Subordinated Loan Agreement. Id. at 48 ("any material breach of or failure to perform any covenant made by any Borrower in connection with the execution of this Agreement, the Letter Agreement, . . . or any other document referred to therein or herein").

The Letter Agreement and the Subordinated Loan Agreement were executed in tandem, are inextricably intertwined and mutually dependent and must be read as a whole, particularly given the underlying circumstances and relationships of the parties. In view of this and the well-established federal policy favoring arbitration, see Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983), the court concludes that pursuant to the

arbitration provision in the subordinated loan document, the arbitration panel had jurisdiction over the Kaplans.

Moreover, any objection petitioners may have had to the authority of the arbitrators was waived. It is well-established that a party who voluntarily and unreservedly submits an issue to arbitration cannot later maintain that the arbitrators acted without authority to resolve that issue. See Pennsylvania Power Company v. Local Union No. 272 of Int'l Broth. of Elec. Workers, 886 F.2d 46, 50 (3d Cir. 1989) (citing Teamsters Local Union v. J.H. Merritt & Co., 770 F.2d 40, 42 (3d Cir. 1985), cert. denied, 474 U.S. 845 (1985)); Jones Dairy Farm v. Local No. P-1236, United Food and Commercial Workers International Union, 760 F.2d 173, 175 (7th Cir. 1985). It has been held that a party cannot contest the jurisdiction of an arbitration panel, submit the question to the panel and subsequently move to vacate an adverse award for lack of jurisdiction. See Orion Pictures Corp. v. Writers Guild of America, West, Inc., 946 F.2d 722, 725 (9th Cir. 1991) (party challenging jurisdiction had "gone too far down the slippery slope in submitting its dispute to arbitration" and waived its right to de novo judicial review.) See also Ferndale Corp. v. Schulman Urban Development Assoc., 758 F. Supp. 861, 867 (S.D.N.Y. 1990) ("Once a party [contesting jurisdiction] receives notice of his adversary's intention to arbitrate, the proper procedure is to make application by special proceeding to stay arbitration."); Halley Optical v. Jaga Int'l Marketing Corp., 752 F. Supp. 638, 639 (S.D.N.Y. 1990).

In Halley Optical, an arbitration panel entered an award against a corporation and its president. The president moved to vacate the award against him in his personal capacity on the ground that he was not party to the agreement containing the arbitration clause. He contested before the arbitrators whether the arbitration clause applied to him, but did not move for a stay. The court concluded that he waived judicial review of jurisdictional objections to the arbitration. The Court stated:

> To find otherwise would allow a party to participate in an arbitration, with the assurance that if it loses it may later challenge whether it had ever agreed to arbitration. Such a result is contrary to the clear policy favoring arbitration.

Id. at 639-40.

The standard for waiver in the Third Circuit requires a clear indication by a party of his willingness to forego judicial review. Pennsylvania Power, 886 F.2d at 50 (citing Local 719, American Bakery & Confectionery Workers of America v. National Biscuit Co., 378 F.2d 918, 921-22 (3d Cir. 1967)). In the instant case, petitioners clearly indicated their willingness to submit to the authority of the arbitration panel and forego any jurisdictional objections.

At a pre-hearing conference on February 26, 1990, the Kaplans voluntarily withdrew jurisdiction objections previously filed, and participated in a discovery conference which was an integral part of the arbitration proceedings.

Stip. at ¶ 5. The panel thereafter rendered decisions pertaining to the parties' various discovery requests, preliminary objections and motions. Stip. at ¶ 6; Rec'd. at 130. There was no need or logical reason for the panel to address the Kaplans' initial objection to jurisdiction as that objection had been withdrawn. Only in January 1992, two and one-half years after the arbitration process had commenced and two years after withdrawing jurisdictional objections, did the Kaplans file a motion to dismiss for lack of jurisdiction. See Stip., ¶¶ 9,11. The motion was denied on January 14, 1992. Stip., ¶ 12.

A finding of waiver is entirely consistent with the cases relied on by petitioner, none of which presented facts remotely similar to those in the instant case. In one, the party challenging the jurisdiction of the arbitrator expressly reserved his right to judicial review and stated at the opening of the proceeding that it would not recognize the validity of the arbitrator's decision. National Biscuit Co., 378 F.2d at 921. In the other, the party challenging arbitrability "repeatedly" raised an objection and "consistently" maintained its position. Pennsylvania Power, 886 F.2d at 50.[7]

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[7] Petitioners also cite a footnote in International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America, Local 249 v. Western Pennsylvania Motor Carriers Ass'n, 574 F.2d 783, 786 n.2 (3d Cir. 1978), cert. denied, 439 U.S. 828 (1978) for the proposition that proceeding on the merits before an arbitrator does not constitute waiver. The footnote cites National Biscuit which is factually distinguishable and the facts pertinent to the waiver question

In contrast, the Kaplans neither expressly reserved nor consistently maintained an objection to the arbitration panel's jurisdiction. Rather, they withdrew a jurisdiction objection and for two years, while the arbitration process ensued, expressed no unwillingness to abide by the arbitrators' decision. See Yorkaire, Inc. v. Sheet Metal Workers, Local 19, 758 F. Supp. 248, 253 (E.D. Pa. 1990), aff'd mem, 931, F.2d 53 (3d Cir. 1991) (party waives right to judicial review where he submits jurisdictional questions to arbitrator and does not indicate unwillingness to be bound by decision).

Clearly, at some point in the arbitration process, a party can no longer be allowed to change his position about his acceptance of an arbitrator's jurisdiction. Otherwise, a party could raise such objections whenever a ruling is made or the process unfolds contrary to his expectations or interests. A party reasonably cannot "reverse course" about an arbitration panel's jurisdiction once the arbitration process has commenced and matters pertinent to the arbitration have been litigated and ruled upon.

There is another compelling fact in the instant case. Manuel Kaplan submitted counterclaims in this matter to the panel which were never withdrawn. In fact, a motion by First Options to dismiss those counterclaims was denied on February 27, 1990, at the very time Mr. Kaplan withdrew his jurisdictional objection. This action also

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in International Brotherhood cannot otherwise be gleaned from the opinion.

manifests a clear acceptance of the arbitration panel's authority.

Where a party has waived jurisdictional objections, the court reviews a decision to exercise jurisdiction like any other arbitration decision only for a manifest disregard of law. See Yorkaire, Inc., 758 F. Supp. at 255. As discussed above, the court concludes that even under a de novo review, the panel properly exercised jurisdiction. Accordingly, the arbitrators' decision to exercise jurisdiction would not be in manifest disregard of the law.

B. Alleged Bias of the Panel

To invalidate an award for "evident partiality" pursuant to § 10(a) (2), "the challenging part must show that 'a reasonable person would have to conclude that the arbitrator was partial' to the other party to the arbitration." See Apperson v. Fleet Carrier Corp., 879 F.2d 1344, 1358 (6th Cir. 1989) (quoting Morelite Const. Corp. v. New York City District Council Carpenters Benefit Fund, 748 F.2d 79, 84 (2d Cir. 1984)), cert. denied, 495 U.S. 947 (1990)). "Evident partiality" is "strong language" and requires proof of circumstances "powerfully suggestive of bias." Merit Ins. Co. v. Leatherby Ins. Co., 714 F.2d 673, 681-82 (7th Cir.), cert. denied. 464 U.S. 1009 (1983), mandate modified, 728 F.2d 943 (7th Cir. 1984). See also Lascho Ins. v. Erickson, 700 F. Supp. 960 (N.D. Ill. 1988) (denial of petitioner's discovery request, refusal to impose sanctions on respondent, misapplication of law and refusal to consider new evidence after close of hearing insufficient to establish partiality). The burden to prove such

circumstances rests squarely upon the party challenging the award. Sheet Metal Workers Int'l Assoc., 756 F.2d at 745.

Petitioners cite fourteen instances which they allege collectively substantiate bias.

1. The Vacation of a Discovery Order

On February 26, 1990, the Arbitration Committee, from which the panel was drawn, denied First Options' request for certain discovery materials concerning MKI's corporate activities predating the Work-Out. Stip. at ¶ 22. One member of the Committee who participated was Michael Waber, a business associate of Manuel Kaplan. Id. at 23-24. The seven panel members subsequently chosen to take testimony reviewed the initial decision and vacated it.[8]

Petitioners do not request review of the merits of the panel's amended discovery order, but merely assert that the reconsideration of the previous order was "fundamentally unfair." See Pets.' Br. at 27. The participation of an associate of Mr. Kaplan provided a reasonable basis for the panel's reconsideration of the prior discovery order.

2. Release of Morgan Stanley Transcript

First Options requested access to a transcript of an unrelated arbitration proceeding conducted by the Exchange involving MKI and Morgan Stanley. Stip. at ¶

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[8] The Committee is comprised of at least eleven members but only a quorum is required for it to act. First Options' were unaware that Mr. Waber had participated until December 1991.

31. Petitioners objected and the request was denied on October 4, 1989. Stip. at ¶¶ 32-33. Subsequently, Morgan Stanley requested and obtained the record of its proceeding from the Exchange and provided it to First Options. Id. at ¶¶ 33-35.

That Morgan Stanley procured the record of an arbitration proceeding in which it was a party and then shared it with First Options does not demonstrate that the panel in this case was biased.

3. Discovery Ruling

First Options' objection to a discovery request by petitioners regarding First Options' piercing-the-veil theory as "contention" interrogatories was sustained. Id. at ¶ 37. First Options had interrogatories stricken for the same reason. Id. It is not error to deny discovery requests related to legal theories and, in any event, the panel's denial of comparable requests by all parties does not demonstrates bias.

4. Admission of Typed Summaries

Nine typewritten documents relating to the subject of the testimony of an accountant for First Options were admitted into evidence. Id. at ¶ 43; Tr. 381-431. Counsel for First Options had contacted the Director of Arbitration for the Exchange to confirm that it did not require that summaries, compilations and analyses be produced prior to an arbitration hearing. Stip. at ¶ 44.

Petitioners contend that the summaries were improperly admitted on the basis of a pre-hearing ex parte ruling by the Director of Arbitration. While it would be advisable for the Exchange promptly to acquaint all parties with the pertinent procedural rules of its arbitration program without waiting for specific inquiries, the Director did not render a "ruling" and would not have the power to do so. The panel's decision to admit summaries prepared by the accountant-witness does not demonstrate bias.

5. and 6. Mr. Windus' Rebuttal Testimony

Petitioners contend that in allowing the "rebuttal testimony" of Mr. Gary Windus and restricting examination of the witness, the panel was fundamentally unfair. First Options sought permission to call Mr. Windus in rebuttal. The witness had been subjected to extensive prior examination by both parties. The panel, after deliberation, decided to allow him to give rebuttal testimony limited to several narrow points deemed appropriate and posed three questions designed by the panel to elicit succinctly the pertinent information. Tr. at 894-95. The panel stated:

> Gentlemen, after deep discussion we have agreed to allow Mr. Windus to testify . . . . We are going to ask the questions. We have outlined three questions that we will ask Mr. Windus and that will be it. O.K.

The panel asked the questions and neither party was allowed to engage in further examination. This decision

does not demonstrate bias. Indeed, in response to the panel's proposal, counsel for petitioners stated: "If we'd done this with every other witness it would be a lot easier." Id.

7. Closing Arguments

Petitioners requested two hours for closing arguments. Stip. at ¶ 51. The panel granted twenty minutes to each side and then extended that time to forty minutes for each party. Id. at ¶ 52. The panel denied petitioners' request for rebuttal argument. Id. at ¶ 47.

Petitioners contend that as a result, counsel for First Options was able to make an unrebutted reference to material outside the record in his closing argument. Petitioners specify only one isolated oblique comment: "First Options did want a lot [in the workout negotiations]. I was around back then. I know they wanted a lot." There is no basis to conclude that the arbitrators failed to appreciate the distinction between testimony and arguments of counsel, and no suggestion that petitioners' counsel was deprived of the ability to register an objection to this comment as referring to a matter beyond the record. The panel's procedures regarding closing arguments does not demonstrate bias.

8. Testimony by Telephone

The panel ruled on April 30, 1992 that "any witness" could testify by telephone. Id. at ¶ 13 (emphasis added). Three witnesses for First Options so testified. Id.

at ¶ 53. There is no suggestion that petitioners ever sought to introduce any testimony by telephone or were deprived of the opportunity to do so. That the panel offered both sides the opportunity to have witnesses testify by telephone and only one party utilized that procedure does not demonstrate bias.

9. Refusal to Pursue Allegation of Witness Tampering

At the beginning of the proceeding, counsel disputed the propriety of a subpoena issued to Seymour Specter, an employee of Bear Stearns & Co. Supp. at ¶¶ 1-2. He was to have been an expert witness for petitioners but they voluntarily withdrew his name and subpoena. Id. First Options called as an expert, Scott Talento, another employee of Bear Stearns & Co. Id. Counsel for petitioners sought to ask Mr. Talento whether someone at Bear Sterns had told Mr. Specter not to testify for petitioners and an objection was sustained. Petitioners were entitled to call Mr. Specter as a witness and ask him about any relevant matter about which he was competent to testify. They decided not to do so. The decision to sustain objections to questions about what may have been communicated to an individual other than the witness was not inappropriate and does not demonstrate bias.

10. Transcription of Testimony

Late in the proceedings, First Options asked the Director of Arbitration to transcribe one day of Manuel Kaplan's testimony. Stip. at ¶ 54. She transcribed the

testimony, sent both parties a copy and indicated that she would not make further transcriptions due to the burdens related thereto. Id. at ¶ 55. Petitioners never asked the Exchange to transcribe any testimony and did not object to the decision to refrain from transcribing further testimony. Stip. at ¶ 58.

This occurrence in no way demonstrates bias or partiality.

11. Insensitivity to Religious Practice

The preliminary scheduling of this arbitration included Saturday hearing dates. Id. at ¶ 59. When rescheduled for April 1992, counsel for petitioner requested that no Saturday hearings be held because of his religious practices. Id. at ¶ 60. Ultimately, the hearings were rescheduled to May 1992, and there were no Saturday proceedings. Id. at ¶ 61. Citing religious practice, Manuel Kaplan objected to Friday sessions extending beyond 7:30 p.m. That request was denied. Id. at ¶ 62.

Petitioners contend that the refusal to accommodate Mr. Kaplan's religious practice demonstrates bias. The parties agree that members of the panel are individuals who otherwise hold full-time employment in the securities industry and thus all hearings were held in the evenings. The record indicates that scheduling these hearings had repeatedly presented difficulty for all concerned. There is no suggestion that the panel accommodated any comparable request by persons associated with First Options or that Mr. Kaplan's case would have been

prejudiced by his early departure on a Friday. Nevertheless, the court believes that absent a very compelling reason to the contrary, it would be desirable for the Exchange to accommodate requests such as Mr. Kaplan's. Its failure to do so in the context of the record adduced, however, does not demonstrate bias regarding the merits of the parties' positions.

12. Evidentiary Rulings

Petitioners contend that four evidentiary rulings during the proceedings can only be explained by partiality: (1) the disallowance of certain rebuttal testimony; (2) disallowing testimony on hearsay grounds; (3) allowing testimony on an issue a witness refused to address at a deposition; and, (4) not allowing cross-examination of a witness on a point regarding Mr. Kaplan's purported use of an "unapproved" broker. The Court has reviewed each ruling. They were well within the discretion accorded the panel in conducting its proceedings and do not demonstrate bias.

13. Refusal to Allow Time for Consultation

As noted, Scott Talento was an expert witness on behalf of First Options. Counsel for petitioners asked for a moment to consult before commencing cross-examination. The request was denied. In the absence of evidence that this was a routine practice applied only to petitioners, the Court cannot conclude that the panel was biased based on this ruling.

14. Choice of Language

Petitioners contend that on two occasions the panel's "own words revealed their biases." On the first, the panel Chairperson asked Larry Goldberg, a friend and business colleague of Manuel Kaplan's, whether he had been present in his office on January 16-17, 1989, when that question was not posed during cross-examination. This was a valid and pertinent question from a member of the panel and does not demonstrate bias. On the other occasion, counsel for petitioners was attempting to elicit testimony that the Chief Executive Officer of First Options "lost his cool" on January 17, 1989, after the MKI account had suffered another serious loss. The panel instructed counsel to move on stating: "We recognize how upset a person can be in a situation like that." This does not substantiate a claim of bias.

Able and energetic counsel for petitioners have combed through the voluminous record to extract and string together every instance which one conceivably could argue might be suggestive of partiality. Even taken together, in the context of the proceedings, the instances cited by the petitioners do not remotely satisfy the stringent standard for proving "evident partiality."

C. Manifest Disregard of Law

An award may also be vacated if a panel acted in manifest disregard of the law. "Manifest disregard of law" is a judicially-created ground for vacating an arbitration award. Carte Blanche (Singapore) Pte., Ltd., 888 F.2d at 265; Sheet Metal Workers Int'l Assoc., 756 F.2d at 746. Manifest disregard has been defined as more than a legal error or misunderstanding of the law. "The error must have been obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator." Merrill, Lynch, 808 F.2d at 933-34. An award is not subject to revision unless its terms are "completely irrational." Norad Reinsurance Co., 868 F.2d at 56.

Petitioners contend that the arbitrators' decision to pierce the corporate veil and find Manuel Kaplan personally liable, jointly and severally with MKI, was in manifest disregard of law. It is well-established that the separate and distinct status of a corporate entity may be disregarded to prevent "fraud, illegality, injustice, or when recognition of the corporate entity would defeat public policy or shield someone from liability for a crime." Zubik v. Zubik, 384 F.2d 267, 271-274 (3d Cir. 1967), cert. denied, 390 U.S. 988 (1968). See also United States v. Pisani, 646 F.2d 83, 88 (3d Cir. 1981). Under the alter ego theory, the corporate veil may be pierced upon a showing of such things as:

> (1) gross undercapitalization for its purposes; (2) failure to observe corporate formalities; (3) non-payment of

> dividends; (4) insolvency of the debtor corporation at the time; (5) siphoning of funds of the corporation by the dominant shareholder; (6) non-functioning of other officers and directors; (7) absence of corporate records; or, (8) the fact that the corporation is merely a facade for the operations of the dominant shareholder.

Pisani, 646 F.2d at 88 (citing DeWitt Truck Brokers v. W. Ray Flemming Fruit Co., 540 F.2d 681, 686-87 (4th Cir. 1976)).

The arbitrators' heard considerable testimony regarding the commingling of Mr. Kaplan's personal funds with those of MKI. See, e.g., Tr. at 396-99. This included testimony of transactions in 1986 and 1987 in which:

> a withdrawal of $350,000 was made from the MKI trading account and a deposit into Manuel Kaplan's person checking account of $361,000 was made the same day;
>
> a check was drawn on the MKI trading account which related to the purchase of a house by Mr. Kaplan;
>
> Mr. Kaplan wrote a check for $1.4 million from his personal checking account to cover a margin call that

> required the deposit of a similar sum into MKI's trading account; and,
>
> a withdrawal of $125,000 was made from the MKI trading account, the funds were deposited two days later in Mr., Kaplan's personal checking account and shortly thereafter checks totaling $125,000 were written on that account to pay Mr. Kaplan's personal federal and state income taxes.

There was also other evidence that Mr. Kaplan disregarded corporate formalities and siphoned corporate funds. Manuel Kaplan was the sole shareholder of MKI. Stip. at ¶ 19. Despite the insolvency of MKI, $611,000 in checks were drawn in his favor from the corporate account in the eight weeks following the crash. Tr. at 401-02; Supp. at 1.[9] An accountant testified that in the period from February 1986 until January 1989, Manuel Kaplan removed from the corporate account and used for personal purposes, within forty-eight hours thereof, a total of $4.5 million. Tr. at 399. The accountant also gave a professional opinion that these transactions indicated a commingling of corporate and personal funds, and a personal use by Mr. Kaplan of funds which belonged to the corporation and its creditors. Id. at 400.

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[9] One check for $4,000 was made payable to cash but endorsed and cashed by Mr. Kaplan.

It also appears that Mr. Kaplan may have used a deceptive financing scheme to raise the $500,000 MKI allocation pursuant to the Work-Out and misrepresented the source of that money. Id. at 411-12; Supp. at 2.

There is ample support in the record for the arbitrators' decision to pierce the corporate veil in this case.

Petitioners contend that in any event First Options had unconditionally released Manuel Kaplan from any liability for the debt in the Work-Out. Even if this were so, it would not release MKI from liability for the debt and, on the record adduced, would not preclude a piercing of the corporate veil. More importantly, there was not an unconditional release of Manuel Kaplan. The release provision in the Letter Agreement (Rec'd at 25, ¶ 11) is expressly contingent upon his "complete performance of the terms of this Agreement and other documents contained herein and applicable to them."

It cannot be said that the arbitration panel's decision to pierce the corporate veil was a decision made in manifest disregard of the law.[10]

---

10 The Court agrees with petitioners that it appears that the arbitrators enforced the terms of the work-out agreement. As it reasonably appears that Mr. Kaplan failed to comply with his obligations under the Work-Out, the release by its terms was ineffectual. Thus, First Options' argument that his breach released them from any obligations imposed by the Work-Out, including the release, is superfluous.

D. The Arbitration Award is Fundamentally Flawed

It is averred that the arbitration award cannot be enforced because the award was not signed by every arbitrator concurring in the award but rather only by the Chairperson. It is uncontroverted that the arbitration panel voted 5-2 in support of the award rendered. Stip. at ¶ 68. While this practice of the exchange may be less than desirable,[11] in the absence of any evidence whatsoever that the award was not in fact the judgment and decision of a majority of the members of the panel, it is insufficient to justify vacatur.

CONCLUSION

The documents constituting the work-out agreement were executed in tandem and are interdependent. Particularly given the underlying circumstances and the relationship of the parties, they must be read as a whole. The Subordinated Loan Agreement contains an arbitration provision and expressly incorporates the Letter Agreement signed by the Kaplans. This provides a legitimate basis for the exercise of jurisdiction by the arbitrators. Moreover, by expressly withdrawing a jurisdictional objection and then litigating matters integral to the arbitration process, and in the case of Mr. Kaplan submitting and litigating counterclaims, any jurisdictional objections were waived by petitioners.

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11 See Exchange Rule 950 § 37(a).

Petitioners have failed to demonstrate that the arbitrators were guilty of evident partiality. Indeed, many of the instances cited to substantiate a claim of bias demonstrate that the parties were treated similarly and even-handedly.

The arbitrators did not engage in a manifest disregard of the law. There was ample evidence of the commingling and siphoning of funds by Mr. Kaplan, and of his disregard of corporate formalities to justify the decision of the arbitrators to pierce the MKI corporate veil to prevent an injustice.

There are no grounds to vacate or modify the arbitrators' award in this case. Accordingly, the petition to vacate the award will be denied and the cross-petition to confirm the award will be granted. Appropriate orders will be entered.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

MANUEL KAPLAN,	:	
CAROL KAPLAN	:	**CIVIL ACTION**
and MK INVESTMENTS, INC.	:	
	:	
Petitioners and Cross-respondents	:	
	:	
v.	:	**NO. 92-MC-210**
	:	
FIRST OPTIONS OF CHICAGO, INC.	:	

O R D E R

AND NOW, this 25th day of September, 1992, upon consideration of the Petition to Vacate Arbitration Award of Manuel Kaplan, Carol Kaplan and MK Investments, Inc. and the response of respondent First Options of Chicago, Inc. thereto and following an opportunity for a hearing and argument thereon, consistent with the accompanying memorandum, IT IS HEREBY ORDERED that the Petition is DENIED.

BY THE COURT:

/s/ _____

JAY C. WALDMAN, J.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

MANUEL KAPLAN,	:	
CAROL KAPLAN	:	**CIVIL ACTION**
and MK INVESTMENTS, INC.	:	
	:	
Petitioners and Cross-respondents	:	
	:	
v.	:	**NO. 92-MC-210**
	:	
FIRST OPTIONS OF CHICAGO, INC.	:	

O R D E R

AND NOW, this 25th day of September, 1992, upon consideration of the Cross-Petition of First Options of Chicago, Inc. for Confirmation of Arbitration Award and Entry of Judgment and the response of cross-respondents thereto and following an opportunity for a hearing and argument thereon, consistent with the accompanying memorandum, **IT IS HEREBY ORDERED** that the Cross-Petition is **GRANTED** and accordingly **JUDGMENT IS ENTERED** in favor of First Options of Chicago, Inc. and against MK Investments, Inc. and Manuel Kaplan, jointly and severally, in the amount of $5,662,188, plus interest at the rate of 6% from January 17, 1989 to date, and in favor of First Options of Chicago, Inc.

and against Manuel Kaplan and Carol Kaplan in the amount of $346,342, plus interest at the rate of 6% from January 17, 1989 to date.

BY THE COURT:

/s/ _____

JAY C. WALDMAN, J.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

MANUEL KAPLAN,	:	
CAROL KAPLAN	:	**CIVIL ACTION**
and MK INVESTMENTS, INC.	:	
	:	
Petitioners and Cross-respondents	:	
	:	
v.	:	**NO. 92-MC-210**
	:	
FIRST OPTIONS OF CHICAGO, INC.	:	

ORDER

AND NOW, this 25th day of September, 1992, upon consideration of the Motion for a Preliminary Injunction of First Options of Chicago, Inc. and the response thereto, **IT IS HEREBY ORDERED** that said Motion is **DENIED** as moot.

BY THE COURT:

/s/_____

JAY C. WALDMAN, J.

No. 94-560

OCT 2 7 1994
OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1994

FIRST OPTIONS OF CHICAGO, INC.,

Petitioner,

vs.

MANUEL KAPLAN, CAROL KAPLAN and M.K. INVESTMENTS, INC.,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Where the parties did not clearly and unmistakably agree that the question of arbitrability was for the arbitrators and not for the courts, did the Court of Appeals properly review *de novo* the arbitrators' assertion of jurisdiction over the controversy?

2. Where the district court essentially granted summary judgment on a stipulated record, did the Court of Appeals properly review *de novo* the district court's decision denying a petition to vacate an arbitration award for want of arbitral jurisdiction?

3. Where the express agreements of the parties not only failed to provide evidence of consent to arbitrate, but in fact negated consent to arbitrate, did the Court of Appeals properly find that Philadelphia Stock Exchange rules alone did not suffice to create arbitral jurisdiction over "associated persons" of exchange members?

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No. 94-560

In The

Supreme Court of the United States

October Term, 1994

FIRST OPTIONS OF CHICAGO, INC.,

Petitioner,

vs.

MANUEL KAPLAN, CAROL KAPLAN AND M.K. INVESTMENTS, INC.,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

RESPONDENTS' BRIEF IN OPPOSITION

STATEMENT OF THE CASE

Respondent M.K. Investments, Inc. ("MKI") was an options market maker on the Philadelphia Stock Exchange from 1984 until January 1989. Respondent Manuel Kaplan was the president and, since 1986, the sole shareholder of MKI. Respondent Carol Kaplan is Manuel Kaplan's wife. Petitioner First Options of

Chicago, Inc. ("First Options" or "Petitioner") was MKI's clearinghouse. App. A at 4-5.

In October 1987, as a result of the largest percentage drop in stock exchange history, MKI's trading account lost a $10 million positive balance almost overnight. The net equity in the MKI trading account went from $10.6 million on October 14, 1987 to *negative* $2.1 million on October 19, 1987. App. A at 5.

First Options took control of the MKI account and proceeded to liquidate all of MKI's positions. In the course of that liquidation, First Options decreased the value of the MKI account to *negative* $5.1 million. App. A at 5-6. MKI, the Kaplans, and First Options entered into settlement negotiations regarding that negative balance. On March 24, 1988, they executed a 4-contract, 28-page settlement/workout agreement, which detailed the parties' rights and liabilities. App. A at 6.

Because certain aspects of the workout agreement were applicable only to certain parties, the agreement consisted of four separate contracts, each signed by different parties. Critically, only one of the four contracts (the MKI Subordinated Loan Agreement) contained an arbitration clause, *and that contract was signed only by First Options and MKI, and not by Manuel or Carol Kaplan.* Manuel and Carol Kaplan signed only one of the four contracts (the Letter Agreement), and that contract *did not contain an arbitration clause.* App. A at 6-7.

In June 1989, First Options filed a Statement of Claim with the Philadelphia Stock Exchange ("the Exchange"), alleging that Respondents had breached the workout agreement and seeking an arbitration award against the Respondents. MKI and First Options (*but neither Manuel nor Carol Kaplan*) signed a submission agreement, presenting this case to the Exchange for arbitration. Manuel and Carol Kaplan *refused* to sign any submission

agreement, and instead formally and timely objected to Exchange jurisdiction. App. A at 10-11, 18.

On February 26, 1990, the Exchange conducted a pre-hearing discovery conference. The Kaplans' counsel withdrew their jurisdictional objections from consideration at that conference, and the arbitrators therefore made no mention of the jurisdictional issue in their February 26, 1990 discovery ruling. The case then lay dormant for the next 22 months. For almost two years, no discovery took place, no motions were filed, and no rulings were issued. App. A at 11.

In December 1991, the Kaplans engaged new counsel. On January 6, 1992, Manuel and Carol Kaplan filed a motion to dismiss for lack of jurisdiction. The arbitrators denied the motion to dismiss on January 14, 1992. *Id.*

On June 5, 1992, the arbitrators issued an award requiring MKI and Manuel Kaplan, jointly and severally, to pay First Options $5,662,188 plus interest, and requiring Manuel and Carol Kaplan, jointly and severally, to pay First Options $346,342 plus interest. App. A at 12. Respondents timely filed a petition to vacate the arbitration award, and First Options filed a cross-petition to confirm the award.

In an unpublished memorandum and order entered September 25, 1992, the district court confirmed the arbitration award. The court held that Manuel and Carol Kaplan had consented to arbitration by virtue of the arbitration clause in the Subordinated Loan Agreement, even though neither Manuel nor Carol Kaplan had signed the Subordinated Loan Agreement. Alternatively, the court held that the Kaplans' former counsel's participation in the 1990 discovery conference had waived their jurisdictional objections. App. A at 12. Respondents timely appealed the district court's decision.

On March 31, 1994, in a unanimous Opinion reported at 19 F.3d 1503 (3d Cir. 1994), the Court of Appeals affirmed the district court's judgment as to MKI, but reversed the judgment as to Manuel and Carol Kaplan, holding that the arbitrators lacked jurisdiction over the Kaplans. App. A at 3-4. On June 29, 1994, the Court of Appeals denied First Options' Petition for Rehearing with Suggestion for Rehearing In Banc. App. B at 1-2.

In its unanimous Opinion, the Court of Appeals held: (a) that it would review *de novo* the district court's denial of Respondents' petition to vacate the arbitration award, App. A at 13; (b) that the Kaplans had not waived their jurisdictional objections, App. A at 17-21; (c) that because arbitrability is a question for the court to decide, the arbitrators' assertion of jurisdiction over the Kaplans was not entitled to deference, App. A at 22-23; (d) that the arbitrators lacked jurisdiction over the Kaplans, App. A at 3-4; and (e) that the evidence was insufficient to allow the piercing of MKI's corporate veil to impose $5,662,188 in personal liability upon Mr. Kaplan, App. A at 52.

SUMMARY OF ARGUMENT

In *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. 643, 649 (1986), this Court held that "[t]he question of arbitrability . . . is undeniably an issue for judicial determination. Unless the parties clearly and unmistakably provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator." The standard set forth by this Court in *AT&T Technologies* is *the* standard for determining when courts should independently decide arbitrability; there is no conflict among the Circuits on this issue. Petitioner's purported conflict among the Circuits is in reality simply a disagreement with the Court of Appeals' correct application of this settled standard to the facts of this case. Because this Court has already provided sufficient guidance concerning when courts should independently

determine arbitral jurisdiction, First Options' petition for certiorari should be denied.

The district court evaluated the parties' respective petitions to vacate or confirm the arbitration award based on the arbitration record and stipulated facts. The court held no evidentiary hearing and made no credibility determinations. The proceeding was highly analogous to the consideration of cross-motions for summary judgment. Therefore, the Court of Appeals properly reviewed the district court's decision to confirm the arbitration award *de novo*, applying the same standard the district court should have used. The *de novo* standard, which is applied in at least nine of the Circuits, provides appropriate deference to the arbitrators and best comports with the summary nature of the proceedings before the district court. Therefore, this Court should deny Petitioner's request that it grant certiorari to adopt a dual standard of review that would provide for *de novo* review of district court decisions vacating arbitration awards and abuse-of-discretion review of decisions denying vacatur.

The Court of Appeals held that where, as here, the parties' agreements and conduct plainly negate consent to arbitrate, stock exchange rules alone do not confer arbitral jurisdiction over "associated persons" of Exchange members. That holding followed logically from the axiom that "arbitrators derive their authority to resolve disputes only because the parties have agreed in advance to submit such grievances to arbitration." *AT&T Technologies*, 475 U.S. at 648-49. Here, the parties' agreements and conduct clearly demonstrate that the Kaplans did not agree to arbitrate their dispute over the workout agreement with First Options. Because the Court of Appeals' holding on this issue was exceedingly narrow, fact-bound, and eminently reasonable, this Court should deny certiorari.

REASONS FOR DENYING THE WRIT

I.

THIS COURT'S PRIOR DECISIONS ALREADY DELINEATE WHEN FEDERAL COURTS SHOULD INDEPENDENTLY DETERMINE ARBITRAL JURISDICTION.

In *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. 643 (1986), this Court, in a unanimous decision, delineated the circumstances in which courts should independently determine arbitral jurisdiction:

> [T]he question of arbitrability ... is undeniably an issue for *judicial* determination. Unless the parties *clearly and unmistakably* provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator.

Id. at 649 (emphasis added). *See also, id.* at 647 ("issue of arbitrability is for the courts to decide unless the parties stipulate otherwise"). This rule "follows inexorably" from the principle that " 'arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.' " *Id.* at 648 (*quoting United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960)).

The standard set forth in *AT&T Technologies* is *the* standard for determining when courts should independently decide the question of arbitrability; there is no conflict among the Circuits on this issue. Petitioner claims to see such a conflict among the Circuits; in reality, Petitioner simply disagrees with the Court of Appeals' correct application of settled law to the facts of this case. The Court of Appeals held, based on stipulated facts, that the

parties had not clearly and unmistakably provided that the question of arbitrability was for the arbitrators rather than the courts, and therefore the court appropriately made an independent determination of arbitrability.

The decisions of the United States Court of Appeals for the First Circuit cited by Petitioner at footnote 6 of its Petition are particularly illustrative of the absence of any conflict among the Circuits as to the applicable legal standard. In *Mobil Oil Corp. v. Local 8-766, Oil, Chem. & Atomic Workers Int'l Union*, 600 F.2d 322 (1st Cir. 1979), the employer maintained before the arbitrator that the dispute was not arbitrable, while the Union argued that it was arbitrable. *Id.* at 323-24. The arbitrator agreed with the Union that the dispute was arbitrable and found for the Union on the merits. *Id.* at 324. The employer moved to vacate the arbitrator's award, and the district court denied the motion. On appeal, the United States Court of Appeals for the First Circuit held that the district court had erred by failing to review *de novo* the arbitrator's determination of arbitrability. *Id.* at 325. Thus, even though the parties had argued the arbitrability issue before the arbitrator, and the arbitrator had decided the issue, the Court of Appeals held that the district court should have decided the arbitrability question *independently. Id.*

First Options cites *Local 369, Utility Workers Union v. Boston Edison Co.*, 752 F.2d 1 (1st Cir. 1984), for the proposition that the First Circuit reviews with deference an arbitrator's determination of arbitrability. In that case, however, "[t]he parties *agreed* to submit to the arbitrator only the question of jurisdiction." *Id.* at 2 (emphasis added). The court held that "'where the parties had agreed, by contract or post-dispute stipulation, to submit the issue of arbitrability to arbitration,'" a deferential standard of review applied. *Id.* at 3 (quoting district court opinion). Here, in marked contrast, the Kaplans did not agree to submit any question to the arbitrators for final decision.

As it was in *Local 369*, the issue of arbitrability is often submitted to an arbitrator by *agreement* of the parties — *i.e.*, the parties sign a submission agreement listing arbitrability as an issue to be decided by the arbitrator. In such cases, deferential review may be appropriate under *AT&T Technologies*.[1] Here, however, the Kaplans did not agree to submit *any* issue to the arbitrators for final decision, and therefore the Court of Appeals properly addressed arbitral jurisdiction independently. *See AT&T Technologies*, 475 U.S. at 649 ("Unless the parties clearly and unmistakably provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator.").

Petitioner complains that it is "extremely unfair" to permit a party contesting arbitral jurisdiction to obtain a *de novo* review of an arbitrator's jurisdictional decision after the arbitrator has ruled on the merits. Petition at 16. However, as the United States Court of Appeals for the Third Circuit pointed out in *Local 719, American Bakery & Confectionery Workers v. National Biscuit Co.*, 378 F.2d 918 (3d Cir. 1967), exactly the same result occurs where a party unsuccessfully challenges jurisdiction in federal district court — the Court of Appeals reviews the jurisdictional decision *de novo* after the district court renders its judgment on the merits:

> In our own federal litigation system we require no special jurisdictional appearances and permit no interlocutory appeals from a court's

1. Indeed, the United States Court of Appeals for the Third Circuit recently held that where the parties expressly *agreed* to arbitrate the question of arbitrability, deferential review of the arbitrator's determination of that question was appropriate. *Pennsylvania Power Co. v. Local Union No. 272 of the Int'l Bhd. of Elec. Workers*, 886 F.2d 46, 48 (3d Cir. 1989). As mandated by *AT&T Technologies*, courts in the Third Circuit review arbitrability determinations with deference only where "the parties clearly and unmistakably provide" that the question of arbitrability is for the arbitrator. *See AT&T Technologies*, 475 U.S. at 649.

> decision in favor of its jurisdiction. Since federal labor policy with respect to arbitration favors the establishment of a private juridical system, there is even less reason to make resort to interstitial judicial activity mandatory, when the possibility exists that a labor dispute can be settled without any use of the courts whatsoever. Thus, where as here the reluctant party has presented its objection to arbitrability to the arbitrator and has not thereafter clearly indicated its willingness to forego judicial review, we believe that the issue is sufficiently preserved for our subsequent inquiry.

Id. at 921-22 (footnotes omitted). *See also, Davis v. Chevy Chase Fin. Ltd.*, 667 F.2d 160, 168 (D.C. Cir. 1981) ("[W]e agree with the court in *Local 719* that such a rule [limiting judicial review of an arbitrator's determination of arbitrability] might actually *foster* litigation by requiring parties disputing arbitrability to seek 'interlocutory' review of jurisdictional rulings.").[2]

Moreover, Petitioner could have moved the federal district court to compel arbitration when the Kaplans objected to arbitral jurisdiction and refused to sign a submission agreement. *See* 9 U.S.C. § 4. Petitioner *chose* not to do so and, therefore, should not be heard to complain of any alleged "unfairness" resulting from the

2. The rule advocated by Petitioner would waste both arbitral and judicial resources. Instead of giving arbitrators a meaningful opportunity to recognize their lack of jurisdiction and dismiss an unauthorized arbitration without need for judicial intervention, Petitioner's rule would require a party opposing arbitrability either to litigate the jurisdictional issue exclusively in federal court or be bound by an arbitrator's erroneous assertion of jurisdiction. It makes far more sense to allow the arbitrators the chance to nip an unauthorized arbitration in the bud, and to involve the federal courts only if the arbitrators fail to acknowledge their lack of jurisdiction.

timing of the Court of Appeals' reversal of the arbitrators' erroneous assertion of jurisdiction over the Kaplans.

Petitioner does not, and cannot, deny that *AT&T Technologies* governs the determination of the appropriate standard of review of an arbitrator's determination of arbitrability. *See* Petition at 13. The parties disagree only as to whether, under the particular circumstances of this case, the Court of Appeals correctly determined that the Kaplans had not "clearly and unmistakably" agreed to submit the question of arbitrability to the arbitrators. *See AT&T Technologies*, 475 U.S. at 649. This is not the sort of dispute which merits the granting of a petition for a writ of certiorari. *See* Sup. Ct. R. 10.1.[3]

II.

THE COURT OF APPEALS PROPERLY REVIEWED *DE NOVO* THE DISTRICT COURT'S DENIAL OF THE PETITION TO VACATE THE ARBITRATION AWARD FOR WANT OF ARBITRAL JURISDICTION.

The Court of Appeals reviewed *de novo* the district court's denial of the Kaplans' petition to vacate the arbitration award for want of arbitral jurisdiction. App. A at 13. Such a standard of review is plainly appropriate. The district court did not hold an evidentiary hearing or make credibility determinations, but rather based its analysis on the arbitration record and stipulations of fact. App. C at 1-2. Therefore, the Court of Appeals had no reason to defer to the district court's denial of the petition to vacate.

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3. Moreover, because the circumstances of this case plainly demonstrate that the Kaplans did not agree to commit the jurisdictional issue (or *any* issue) to the arbitrators for final decision, the Court of Appeals properly made an independent determination of arbitrability.

The district court's procedure in addressing the parties' respective petitions to vacate or confirm the arbitration award was analogous to the consideration of cross-motions for summary judgment. *See Air Line Pilots Ass'n Int'l v. Aviation Assocs.*, 955 F.2d 90, 93 (1st Cir.), *cert. denied*, 112 S. Ct. 3036 (1992) ("Summary judgment is clearly an appropriate mode for the resolution of an action to enforce an arbitrator's award. . . . [T]he enforcement proceeding is by nature summary."). It follows that review by the Court of Appeals should likewise be analogous to that applied in reviewing summary judgment determinations; *i.e.*, *de novo*. *See Petruzzi's IGA Supermarkets, Inc. v. Darling-Delaware Co.*, 998 F.2d 1224, 1230 (3d Cir.), *cert. denied*, 114 S. Ct. 554 (1993).

Petitioner complains that the *de novo* standard of review "fails to give the appropriate level of deference to the decisions of arbitrators." Petition at 19. However, as demonstrated in section I., *supra*, the arbitrators' erroneous assertion of jurisdiction over the Kaplans was not entitled to any deference, because "the question of arbitrability . . . is undeniably an issue for *judicial* determination." *AT&T Technologies*, 475 U.S. at 649 (emphasis added).

Moreover, in reviewing *de novo* a district court's determination whether to vacate an arbitration award, the Court of Appeals merely puts itself in the shoes of the district court. *See* App. A at 13; *Moseley, Hallgarten, Estabrook & Weeden v. Ellis*, 849 F.2d 264, 267 (7th Cir. 1988). Therefore, where deference to arbitral determinations is appropriate, the Court of Appeals, like the district court, will defer. There is no cogent reason for the Court of Appeals to defer to the district court, rather than to the arbitrators themselves. *See Labor Relations Div. of Constr. Indus. v. International Bhd. of Teamsters, Local No. 379*, 29 F.3d 742, 745 (1st Cir. 1994) ("all deference is due to the arbitrator's interpretation of the contract, not to the interpretation of the district court").

Indeed, at least nine of the Circuits have already held that Courts of Appeal should review denials of petitions to vacate arbitration awards *de novo*. *See, e.g., Advest, Inc. v. McCarthy*, 914 F.2d 6, 8 (1st Cir. 1990); *In re Arbitration No. AAA 13-161-0511-85*, 867 F.2d 130, 131 (2d Cir. 1989); *Kaplan v. First Options of Chicago, Inc.*, 19 F.3d 1503, 1509 (3d Cir. 1994) (App. A at 13); *Amerada Hess Corp. v. SS Athena*, 1987 WL 37022, at *1 (4th Cir. Apr. 9, 1987) (unpublished decision); *McIlroy v. PaineWebber, Inc.*, 989 F.2d 817, 819-20 (5th Cir. 1993); *Moseley, Hallgarten, Estabrook & Weeden v. Ellis*, 849 F.2d 264, 267 (7th Cir. 1988); *Pack Concrete, Inc. v. Cunningham*, 866 F.2d 283, 284 (9th Cir. 1989); *Bowles Fin. Group, Inc. v. Stifel, Nicolaus & Co.*, 22 F.3d 1010, 1012 (10th Cir. 1994); *Parmac, Inc. v. I.A.M. Nat'l Pension Fund Benefit Plan*, 872 F.2d 1069, 1071 (D.C. Cir. 1989).

Petitioner suggests that this Court grant certiorari to adopt the "dual standard of review" set forth in *dicta* by the United States Court of Appeals for the Eleventh Circuit in *Robbins v. Day*, 954 F.2d 679, 681-82 (11th Cir.), *cert. denied sub nom. Robbins v. PaineWebber, Inc.*, 113 S. Ct. 201 (1992).[4] Petition at 21. That standard, however, unfairly stacks the deck in favor of arbitration, even where, as here, the parties never agreed to arbitrate their dispute. As the Eleventh Circuit itself has recognized,

> A duty to arbitrate does not arise because a court thinks it is a good thing to require in the circumstances or because national labor policy favors it. A party cannot be required to submit to arbitration a dispute that it has not agreed to arbitrate.

4. In *Robbins*, the court *held* that a *de novo* standard of review applied to the district court's order to vacate the arbitration award. 954 F.2d at 681. The court's statement that district court decisions denying vacatur would be reviewed for abuse of discretion is pure *dictum*. *See id.*

Road Sprinkler Fitters Local Union No. 669 v. Independent Sprinkler Corp., 10 F.3d 1563, 1567 (11th Cir.), *cert. denied*, __ S. Ct. __, 63 U.S.L.W. 3244 (1994) (*citing United Steelworkers v. Warrior & Gulf Co.*, 363 U.S. 574, 582 (1960)).

Because district courts' summary determinations are not entitled to deference on appeal, this Court should decline Petitioner's invitation to grant certiorari to upset the settled law of at least nine Circuits by adopting the Eleventh Circuit's dual standard of review.[5]

III.

THE COURT OF APPEALS CORRECTLY HELD THAT WHERE, AS HERE, THE PARTIES' AGREEMENTS AND CONDUCT PLAINLY NEGATE CONSENT TO ARBITRATE, STOCK EXCHANGE RULES ALONE DO NOT CONFER ARBITRAL JURISDICTION OVER "ASSOCIATED PERSONS" OF EXCHANGE MEMBERS.

The narrow and unremarkable holding of the Court of Appeals is that where, as here, the parties' agreements and conduct plainly *negate* consent to arbitrate, stock exchange rules alone do not

5. Even if it had adopted the Eleventh Circuit's dual standard of review, the Court of Appeals would have reached the same result, because by applying an incorrect legal standard to the arbitrators' jurisdictional determination, the district court abused its discretion. *See* App. A at 52 (district court applied incorrect standard of review to arbitrators' jurisdictional decision); *Harris v. Reeves*, 946 F.2d 214, 218 n.6 (3d Cir. 1991), *cert. denied*, 112 S. Ct. 1516 (1992); *Institutionalized Juveniles v. Beal*, 758 F.2d 897, 926 (3d Cir. 1985) ("by applying an incorrect legal standard, the district court abused its discretion"). It would not be an efficient use of this Court's limited resources to choose between two standards of appellate review, both of which would lead to the same result in this case.

confer arbitral jurisdiction over "associated persons" of Exchange members. App. A at 36-40. As the Court of Appeals noted, "[t]he circumstances of this case plainly negate the Kaplans' consent to arbitrate their individual responsibility for MKI's obligations. . . . There is no ambiguity about the absence of any consent to arbitrate in the documents the Kaplans signed individually." App. A at 26-27.

Contrary to Petitioner's prophesies of doom, the decision of the Court of Appeals does not "threaten[ ] the entire structure . . . of self-regulation by national securities exchanges and associations." Petition at 22. In reality, the decision simply applies this Court's requirement that such organizations obtain *consent* before hauling "associated persons" of members into arbitration. *See AT&T Technologies*, 475 U.S. at 648-49 ("arbitrators derive their authority to resolve disputes only because the parties have agreed in advance to submit such grievances to arbitration").

Unable to point to any agreement by the Kaplans to arbitrate this dispute, Petitioner relies on Mr. Kaplan's purported status as an "associated person" of MKI under the rules of the Exchange in support of arbitral jurisdiction.[6] However, as the Court of Appeals held, the Exchange's rules *alone* do not create arbitral jurisdiction where the surrounding circumstances plainly *negate* an intention to arbitrate. App. A at 34 (*quoting Gateway Coal v. United Mine Workers*, 414 U.S. 368, 374 (1974) ("No obligation to arbitrate . . . arises solely by operation of law. The law compels a party to submit his grievance to arbitration only if he has contracted to do so.")).[7]

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6. First Options does not even contend that Mrs. Kaplan was an "associated person" of MKI, and offers *no* basis for the arbitrators' assertion of jurisdiction over her.

7. The Court of Appeals did *not* hold that independent evidence of consent to arbitrate is *always* required to compel "associated persons" to arbitrate their (Cont'd)

As the Court of Appeals observed, "[m]ost of the cases that have considered whether persons associated with members of an exchange must arbitrate a dispute . . . have required evidence other than the rule itself to show the associated person's consent to arbitrate." App. A at 37; *see, e.g., Haviland v. Goldman, Sachs & Co.*, 947 F.2d 601, 604 (2d Cir. 1991), *cert. denied*, 112 S. Ct. 1995 (1992) (arbitration not required unless dispute falls within scope of *both* signed U-4 agreement *and* Exchange arbitration provisions); *Fleck v. E.F. Hutton Group, Inc.*, 891 F.2d 1047, 1049 (2d Cir. 1989) (relying on agreement in signed U-4 to abide by Exchange arbitration rules);[8] *Pearce v. E.F. Hutton Group, Inc.*, 828 F.2d 826, 830 (D.C. Cir. 1987) (same as *Haviland, supra*); *Chisolm v. Kidder, Peabody Asset Management, Inc.*, 810 F. Supp. 479, 481 (S.D.N.Y. 1992) (signing of U-4 form rendered plaintiff subject to Exchange arbitration rules); *Morgan v. Nikko Securities Co.*, 691 F. Supp. 792, 796-97 (S.D.N.Y. 1988) (Exchange arbitration rule inapplicable absent signed U-4); *Francis v. Marshall*, 661 F. Supp. 773, 774 & n.1 (D. Mass. 1987) (relying on signed U-4).

Here, however, "[n]o U-4 Form nor any other document signed by Mr. Kaplan shows he had agreed to arbitrate. . . ." App. A at 39-40. Therefore, the Court of Appeals held:

> We do not think Exchange Rule 950 § 6(a)(2) requires Mr. Kaplan to arbitrate the

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(Cont'd)
disputes with Exchange members. (Such a holding would be consistent with the law. *See* cases cited at 15, *infra*. The facts of this case, however, do not present the issue.) It held only that where, as here, the surrounding circumstances clearly *negate* consent to arbitrate, Exchange rules governing "associated persons" do not alone confer arbitral jurisdiction. App. A at 37.

8. First Option contends that the *Fleck* court did not rely on the existence of a signed U-4 agreement. Petition at 26 n.21. That contention, however, is incorrect. *See Fleck*, 891 F.2d at 1049.

> dispute with First Options over the workout absent other evidence that he has individually agreed to submit to arbitration this particular dispute over his continuing individual responsibility for MKI's obligations. The workout documents themselves not only fail to furnish that evidence, they negate his consent to arbitration. *Because of the nature of this particular dispute and the terms of the workout documents that govern it, we conclude Mr. Kaplan was not required to arbitrate this matter.*

App. A at 37 (emphasis added, footnote omitted).

Under the circumstances of this case, the Court of Appeals correctly found that the Kaplans did not consent to arbitration solely by operation of Exchange Rule 950 § 6(a)(2). There is no necessity for this Court to reconsider this narrow, fact-bound, and eminently reasonable holding.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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In The

Supreme Court of the United States

October Term, 1994

FIRST OPTIONS OF CHICAGO, INC.,

Petitioner,

vs.

MANUEL KAPLAN, CAROL KAPLAN AND M.K. INVESTMENTS, INC.,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

BRIEF FOR AMICI CURIAE PHILADELPHIA STOCK EXCHANGE, INC., CHICAGO BOARD OPTIONS EXCHANGE, INC. AND PACIFIC STOCK EXCHANGE, INC. IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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STATEMENT OF INTEREST OF THE AMICI CURIAE

The Securities and Exchange Commission ("SEC"), pursuant to the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78a *et seq.*, has approved arbitration rules of the various self-regulatory organizations ("SROs") under the SEC's oversight.

Accordingly, the SROs have established SRO arbitration forums to resolve disputes between SRO members

and between SRO members and their customers. Each year thousands of disputes are fairly and efficiently resolved through binding SRO arbitrations – disputes that otherwise would clog state and federal court dockets, taxing not only judicial resources, but the parties' pocketbooks as well. So effective has been the SRO administering of securities arbitrations that this Court has provided a ringing endorsement of the program. *See Rodriguez De Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989). *See also Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

The Philadelphia Stock Exchange, Inc. ("PHLX"), Chicago Board Options Exchange, Inc. and Pacific Stock Exchange, Inc. are SROs registered with the SEC as national securities exchanges. The PHLX and other amici have established and maintain SRO arbitration programs. The amici have a significant and vital interest in the resolution of the issue in this case, specifically the standard of review to be applied to completed arbitrations.

In the instant case, the Third Circuit has dramatically undercut SRO arbitrators' ability to render final, binding arbitration decisions by allowing a court to re-examine *de novo* whether a dispute is arbitrable after the arbitrators have rendered a final decision regarding the dispute. The Third Circuit's decision in this case contravenes not only the basic contract principles of waiver and estoppel, but the clear federal policy in support of arbitration as a fair and efficient means of final and binding dispute resolution for those parties having submitted a dispute to arbitration.

If allowed to stand, the Third Circuit's decision in this case will inevitably have a deleterious impact on the SRO arbitration programs conducted by the amici, initially by undercutting the efficiency and certainty of binding SRO arbitration decisions, encouraging arbitration forum shopping, and ultimately discouraging willing participation in binding arbitration programs. The result will be that more securities disputes will be directed to the already overburdened courts.

SUMMARY OF ARGUMENT

Once parties have proceeded to the merits of the dispute before the arbitrators, the amici have considered the applicable standard of review of SRO arbitrators' decisions on arbitral jurisdiction to be the same standard accorded to the arbitrators' decisions on the merits of the dispute, namely deference. Essentially, this standard permits the courts to overturn the arbitrators' decisions only for a manifest disregard of the law (or as set forth in the applicable statute). *See Nolde Brothers, Inc. v. Bakery Workers*, 430 U.S. 243, 51 L.Ed. 300, 97 S.Ct. 1067 (1977).

This Court should therefore grant the writ of certiorari and resolve the split in the circuits by reaffirming the deferential standard, which provides that once an arbitration decision is rendered as to the merits of a dispute, all substantive decisions made by the arbitrators that led to the final decision on the merits, including any decision as to the arbitrability of the dispute, should receive deferential review by a court. This standard would be consistent with the policies underlying the

Federal Arbitration Act, the federal securities laws' policy favoring arbitration of securities disputes, and this Court's own preference for securities dispute resolution through SEC approved and regulated SRO arbitration programs.

ARGUMENT

I.

CERTIORARI SHOULD BE GRANTED BECAUSE THE THIRD CIRCUIT DECISION OFFENDS CONTRACT AND EQUITY LAW PRINCIPLES AND UNDERMINES THE SECURITIES ARBITRATION SCHEME

Because the recent Third Circuit decision shocks basic contract law principles relating to whether parties have agreed to binding arbitration, and upsets the entire bedrock of the SRO securities arbitration scheme, the amici concur and join in First Options of Chicago, Inc.'s petition for writ of certiorari.

The amici urge this Court to reaffirm the deferential standard of judicial review of final arbitration awards. This standard requires that, once securities arbitrators have been permitted by the parties before them to render a final decision on the merits of a dispute, all predicate decisions to that final decision, including any decision as to arbitrability of the dispute by the arbitrators, must be judicially reviewed with deference afforded to the arbitrators. The corollary standard would be that if a party seeks to contest whether a matter is arbitrable or whether such party is subject to an agreement to arbitrate, that party must immediately seek a judicial determination as

to such issue[s] and/or expressly reserve such right. Failure to take such actions shall constitute a *per se* waiver or estoppel of any right by any party to *de novo* court review of the issue of arbitrability.

In this and a series of other cases, the Third Circuit and the Ninth Circuit have reasoned that when a party merely objects to whether a dispute is arbitrable yet proceeds with costly, time consuming proceedings to a final decision by the arbitrators on the merits of the dispute, the objecting party has not only not waived the right to a judicial determination of the arbitrability issue, but has allowed the court to conduct a full *de novo* review of the issue of arbitrability, which can totally undermine the entire completed proceeding. *See Pennsylvania Power Co. v. Local Union No. 272*, 886 F.2d 46 (3rd Cir. 1989). *See also Local 719, American Bakery & Confectionery Workers of America, AFL-CIO v. The National Biscot Company*, 378 F.2d 918 (3rd Cir. 1967). *See also George Day Construction Co. v. United Brotherhood of Carpenters*, 722 F.2d 1471 (9th Cir. 1984).

The amici contend that the ramifications of court *de novo* review through the issue of arbitrability after the arbitrators have rendered a final decision based on the dispute's merits, undermines the efficacy of the entire arbitration process. First, a standard of *de novo* review creates substantial unfairness. It encourages arbitration respondents to always raise the jurisdictional objection and then seek a decision on the ultimate merits of the case by the arbitrators. If the respondent prevails on the merits, no judicial appeal is taken. On the other hand, if the respondent loses, the respondent will inevitably appeal and request the court to overturn the arbitration

award through a *de novo* review regarding whether the matter was arbitrable in the first instance. Hence, respondent is unfairly afforded two chances to receive a favorable decision to the claimant's one chance.

Second, significant resources are utterly wasted when an arbitration award is reversed by a court's "second guessing" of arbitral jurisdiction. In this arbitration case alone, thousands of hours were expended by the Exchange arbitration administrators, arbitrators, witnesses and the parties themselves, all to no ultimate avail, in an effort to create a final, binding resolution of the dispute. Those thousands of hours reflect hundreds of thousands of dollars in time and effort wasted. According to the Third Circuit, this case must now be relitigated in court all over again. Affording deference to the arbitrators' award, including the decision on the arbitrability of the dispute, would have appropriately assured binding finality to this case. A deference standard appears to be the only intuitive and logical standard of review, which would be consonant with the strong federal policies favoring binding arbitration dispute resolution and this Court's own preference for securities dispute resolution. *See United Steelworkers of America v. American Manufacturing Company*, 363 U.S. 564, 4 L.Ed.2d 1403, 80 S.Ct. 1343. *See also Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

Third, support of a deferential standard of review over issues regarding arbitrability is well underpinned by basic contract principles. In this regard, the amici contend that the Third Circuit incorrectly interpreted contract law when it found that parties do not expressly or by implication waive their right to *de novo* judicial review of the

arbitrability issue when they merely object to jurisdiction, yet proceed to participate in costly and time consuming proceedings on the merits of the dispute to its conclusion. *See* Restatement Second of Contracts Sec. 84 (1981). *See also Reiter v. Yellowstone County, Montana et al.*, 627 P.2d 845, 850 (1981). Moreover, the amici further assert that by not finding such a waiver, the Third Circuit ignored principles of estoppel and good faith and fair dealing, since all parties not only spent considerable time and money on the arbitration proceedings, but also relied to their detriment on the objecting parties' good faith participation in the binding arbitration proceedings. *See* Restatement Second of Contracts Sections 34, 84, 90 and 205 (1981). *See also Neverett v. Towne*, 159 A.2d 345, 351 (1960).

Fourth, the amici also contend that the lack of uniformity on this issue among the circuits presents problems unique to the securities industry. In this regard, because the amici are located in different parts of the country, and share many of the same members, subjecting them to the decisions of different circuits, allows arbitrations to be brought against and/or by those members in any number of amici-operated arbitration fora. In short, forum shopping will be promoted. Arbitrations will be initiated in any amici forum residing within a "favorable" circuit rather than one with a proper venue.

Finally, the Third Circuit decision places a chilling effect on the arbitral process by encouraging SRO arbitrators to either refuse to accept or to readily dismiss matters involving jurisdictional objections. The practical result is an increase in both state and federal court dockets and a delay in the processing of securities

disputes, which runs afoul of the federal policies favoring fair, efficient and speedy resolution of these cases through arbitration.

For the aforementioned reasons, the amici respectfully request this Court grant the petition for writ of certiorari in order to re-establish a uniform, nationwide standard of deferential review of SRO decisions on the issue of arbitrability, thereby restoring the SRO arbitration fora to their original and intended purpose – swift, just, effective and consistent securities dispute resolution.

CONCLUSION

For the reasons set forth above, amici curiae Philadelphia Stock Exchange, Inc., Chicago Board Options Exchange, Inc. and Pacific Stock Exchange, Inc. respectfully request that this Court grant the petition for writ of certiorari to the United States Court of Appeals for the Third Circuit.

Respectfully submitted,

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Assistant General Counsel
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Supreme Court, U.S.
FILED
OCT 27 1994
OFFICE OF THE CLERK

No. 94-560

IN THE
UNITED STATES SUPREME COURT
OCTOBER TERM, 1994

FIRST OPTIONS OF CHICAGO, INC.,

Petitioner,

v.

MANUEL KAPLAN, CAROL KAPLAN AND MK INVESTMENTS, INC.,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF AMICI CURIAE NATIONAL FUTURES ASSOCIATION, CHICAGO BOARD OF TRADE, AND CHICAGO MERCANTILE EXCHANGE IN SUPPORT OF PETITION FOR CERTIORARI

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October 27, 1994

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I. STATEMENT OF INTEREST OF AMICI CURIAE

The Commodity Exchange Act, 7 U.S.C. §§ 1-22 (1994) -- like the Securities Exchange Act of 1934 ("Securities Exchange Act"), 15 U.S.C. §§ 78a-78kk (1994) in connection with the regulation of the securities industry — sets forth a comprehensive system for the federal regulation of the commodity futures industry. See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 355 (1982).

The Chicago Board of Trade ("CBOT") and the Chicago Mercantile Exchange ("CME"), which are futures exchanges, and National Futures Association ("NFA"), which is a registered futures association, are self-regulatory organizations ("SROs") authorized under the Commodity Exchange Act to resolve futures-related disputes through arbitration. See 7 U.S.C. § 7a(11) (1994) and 7 U.S.C. § 21(b)(10) (1994). In fact, futures SROs are required by law to arbitrate certain claims. See Geldermann, Inc. v. Commodity Futures Trading Commission, 836 F.2d 310 (7th Cir. 1987), cert. denied, 488 U.S. 816 (1988). Rules promulgated by the CBOT, CME, and NFA must be submitted to the Commodity Futures Trading Commission ("CFTC") for approval pursuant to Sections 5 and 17, respectively, of the Commodity Exchange Act (7 U.S.C. § 7a(12) (1994); 7 U.S.C. § 21(j) (1994)) and must meet the standards set by CFTC Regulations §§ 180.1-180.5 (17 C.F.R. §§180.1-180.5 (1994)).

The arbitration forums offered by the CBOT, CME, and NFA are very similar to the one at the Philadelphia Stock Exchange which was utilized by the parties in this case. The holding in this case could be applied to similar cases brought by parties to CBOT, CME, and NFA arbitrations in any circuit, and

would almost certainly be applied to cases brought in the Third Circuit. Since that holding is detrimental to the effective functioning of the arbitration programs offered by the CBOT, CME, and NFA, these SROs have a substantial interest in having this Court grant First Options of Chicago, Inc.'s Petition for Certiorari.

The parties have consented to the filing of an Amici Curiae Brief by the CBOT, CME, and NFA. Copies of the consent letters from the parties' respective counsels are attached as Appendix A.

II. REASONS FOR GRANTING THE PETITION FOR CERTIORARI

A. Summary of Argument

The CBOT, CME, and NFA are filing this Amici Curiae Brief in support of the Petition for Certiorari filed by Appellant First Options of Chicago, Inc. These arbitration forums submit that the Third Circuit Court of Appeal's decision dated March 31, 1994 incorrectly applied a de novo standard of review in evaluating the arbitrators' determination on the issue of jurisdiction or arbitrability. This is an important question of federal law which should be decided by this Court due to the harmful impact which the Third Circuit's decision would have on the national policy favoring arbitration of commodity futures and securities disputes and on the Congressional policy of industry self-regulation.

B. The Third Circuit's Decision Could Have Far-Reaching Effects on Securities and Commodity Futures Arbitration Proceedings

The Third Circuit Court of Appeal's decision provides that courts may disregard the determinations of arbitrators on the

arbitrability issue even where the parties had submitted the arbitrability issue to the arbitrator for resolution. As a result, arbitrators who have decided issues of jurisdiction or arbitrability face the prospect of expending substantial time and energy in resolving disputes, only to have a court subsequently render those efforts a nullity.

Individuals who have full-time jobs in the legal field or in the securities or futures industry serve as arbitrators under the auspices of securities or commodity futures SROs, with little or no compensation, for the benefit of the industry and the investing public. These arbitrators are regularly called upon to resolve jurisdictional or arbitrability issues, and they devote substantial effort to the resolution of these issues. Arbitrators often resolve jurisdictional issues in favor of arbitrability and thereafter devote substantial time and effort to deciding the merits of a case.

The Third Circuit's decision in this case creates the distinct possibility that the voluntary efforts of these skilled individuals to adjudicate arbitrability issues, which are both procedural and substantive, will be fruitless. This represents a substantial waste of resources and a disincentive to potential arbitrators to serve. That result is contrary to the securities and commodity futures regulatory framework and to the liberal federal policy in favor of arbitration.

The potential waste of resources — including not only the arbitrators' time, but also the efforts of the officials who administer the arbitral process, the attendance of witnesses, the expense of the arbitral facility, and the cost of legal counsel — and the increased difficulty in attracting the most qualified arbitrators could undermine the comprehensive arbitration systems currently in place in the securities and commodity futures industries, with far-reaching consequences.

To demonstrate how extensive the effects of the Third Circuit's decision could be, over the four-year period from 1990 through 1993 the CBOT, CME, and NFA alone received over 1,400 arbitration claims and disposed of over 1,700 cases, as follows:

YEAR	ENTITY	TOTAL CASES RECEIVED	TOTAL CASES CONCLUDED
1990	CBOT	53	53
	CME	95	82
	NFA	278	454
1991	CBOT	50	49
	CME	90	81
	NFA	232	287
1992	CBOT	32	30
	CME	86	100
	NFA	200	303
1993	CBOT	69	44
	CME	60	76
	NFA	191	180
TOTAL		**1,436**	**1,739**

Furthermore, published information on arbitration cases at the seven largest securities industry SROs shows 16,640 cases filed and 17,465 cases concluded during 1990-1992.

Year	Total Cases Received	Total Cases Concluded
American Stock Exchange		
1990	69	72
1991	51	64
1992	45	55
Chicago Board Options Exchange		
1990	67	85
1991	46	62
1992	28	28
Municipal Securities Rulemaking Board		
1990	75	90
1991	94	82
1992	45	68
National Association of Securities Dealers		
1990	3,617	4,019
1991	4,150	4,037
1992	4,379	4,375
New York Stock Exchange		
1990	1,378	1,466
1991	1,403	1,496
1992	873	1,167

Pacific Stock Exchange

1990	93	68
1991	86	82
1992	58	65

Philadelphia Stock Exchange

1990	29	34
1991	33	32
1992	21	18

Total

1990	5,328	5,834
1991	5,863	5,855
1992	5,449	5,776

5 SECURITIES ARBITRATION COMMENTATOR, Sept. 1993, at 9.

Similarly, the American Arbitration Association reports that 577 securities arbitration claims were filed there in 1991, 485 in 1992, and 635 in 1993. This is only a fraction of its overall filings, which totaled 63,171 in 1993. DISPUTE RESOLUTION JOURNAL, June 1994, at 5; ARBITRATION JOURNAL, March 1992, at 4. *All* of these cases, as well as the thousands of other arbitration cases filed in other arbitration forums each year, are potentially affected by the Third Circuit's ruling imposing a de novo standard of review on an arbitrator's determination of arbitrability.

In many of the cases which have been heard at futures, securities, and other arbitration forums, the arbitrators were presented by the parties with the question of whether the dispute

was arbitrable or whether the arbitration forum had jurisdiction over a party. It is unfair and wasteful to allow a party who unsuccessfully raises the issue of arbitrability before the arbitrators and thereafter participates in the entire arbitration proceeding (without seeking judicial relief or expressly reserving the right to do so), to subsequently reassert the arbitrability issue for de novo review by a court. This result is contrary to the national policy favoring arbitration and presents an important question of federal law which should be settled by this Court.

III. CONCLUSION

For all of these reasons, the Chicago Board of Trade, the Chicago Mercantile Exchange, and National Futures Association respectfully ask this Court to grant the Petition for Certiorari filed by First Options of Chicago, Inc.

Respectfully submitted,

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October 24, 1994

Ms. Kathryn Page Camp
Associate General Counsel
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200 West Madison Street
Chicago, Illinois 60606-3447

RE: Appeal Docket No. 92-1814
Kaplan vs. First Options of Chicago, Inc.

Dear Kathryn:

First Options of Chicago, Inc., through its attorneys Gardner, Carton & Douglas, hereby consents to the filing of an Amicus Brief by the Chicago Board of Trade, the Chicago Mercantile Exchange and the National Futures Association in connection with the case entitled Kaplan v. First Options of Chicago, Inc., No. 94-560.

Sincerely,

Stephen P. Bedell/sma

Stephen P. Bedell

APPENDIX A-2

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October 19, 1994

BY FAX AND MAIL 312-781-1467

Daniel J. Roth
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Re: First Options of Chicago, Inc. v. Kaplan, No. 94-560

Dear Mr. Roth:

Manuel Kaplan, Carol Kaplan, and MK Investments, Inc. hereby give their consent to the Chicago Board of Trade, the Chicago Mercantile Exchange, and the National Futures Association to file an amicus brief in connection with Docket No. 94-560 (U.S.).

Sincerely,

Richard A. Koffman

RECEIVED
OCT 21 1994
GENERAL COUNSEL'S OFFICE

FILED
JAN 19 1995
OFFICE OF THE CLERK

(5)

No. 94-560

In the Supreme Court of the United States

OCTOBER TERM, 1994

FIRST OPTIONS OF CHICAGO, INC., PETITIONER,

v.

MANUEL KAPLAN, CAROL KAPLAN & M.K. INVESTMENTS, INC., RESPONDENTS

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

JOINT APPENDIX

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123 pp

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UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 92-1814

KAPLAN, *et al.* v. FIRST OPTIONS

RELEVANT DOCKET ENTRIES

DATE	DESCRIPTION
1992	
October 5	Civil Case Docketed.
1993	
January 4	Appellants' brief filed.
February 8	Appellee's brief filed.
March 31	Appellants' reply brief filed.
June 23	Case argued and submitted.
1994	
March 31	Opinion filed.
June 15	Appellee's Petition for Rehearing filed.
June 17	Chicago Board of Trade's brief in *amicus curiae* in support of appellee's petition for rehearing filed.
June 29	Appellee's petition for rehearing denied.

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

No. 92-MC-210

KAPLAN, *et al.* v. FIRST OPTIONS

RELEVANT DOCKET ENTRIES

DATE	NO.	DESCRIPTION
1992		
June 8	1	MKI's and Kaplans' petition to vacate arbitration award.
June 25	2	First Options' cross motion to confirm arbitration award and enter judgment.
July 10	5	MKI's and Kaplans' motion for an order vacating arbitration award.
August 7	9	First Options' memorandum in opposition to motion for an order vacating arbitration award.
August 14	10	First Options' motion for preliminary injunction.
August 28	12	MKI's and Kaplans' memorandum in opposition to First Options' motion for preliminary injunction.

September 1	13	MKI's and Kaplans' reply brief in support of their motion for an order vacating arbitration award.
September 2	14	Stipulation of certain facts.
September 2	17	Supplemental stipulated finding of facts.
September 25	22	First Options' motion for preliminary injunction denied as moot.
September 25	—	Motion to vacate arbitration award denied.
September 25	23	Judgment entered.
September 30	26	Kaplans' notice of appeal.
November 12	—	Record complete for purposes of appeal.

LETTER AGREEMENT

March 24, 1988

First Options of Chicago, Inc.
440 South LaSalle Street
Chicago, Illinois 60605

Gentlemen:

1. Statement of Indebtedness. MK Investments, Inc. a corporation organized and existing under the laws of Pennsylvania ("MK"), Duck Brothers, Inc. a corporation organized and existing under the laws of Pennsylvania ("Duck"), and Options Investors, Inc., a corporation organized and existing under the laws of New Jersey ("OI") are presently indebted to you in the aggregate amount of $5,176,953, $2,307,498, and $750,235, respectively, as a result of their trading activities with you. MK is also indebted to you in the amount of $300,0000 representing outstanding claims against MK, Duck and OI by the Exchange (hereinafter defined) or any other entities for unpaid invoices and brokerage bills (the "Brokerage Bills"). MK hereby agrees to assume the indebtedness to you of OI and the Brokerage Bills (to the extent actually paid by you) and hereby affirms that it is indebted to you in the aggregate amount of $6,227,188 (the "MK Indebtedness"). Duck hereby affirms that it is indebted to you in the aggregate amount of $2,307,498 (the "Duck Indebtedness"). MK further unconditionally guarantees the full and prompt payment, subject to the terms of this Agreement, of the Duck Indebtedness evidenced by the Duck Note (hereinafter defined) pursuant to a guaranty substantially in the form of Exhibit A hereto (the "Guaranty"). The MK Indebtedness plus the amount of the Duck Indebtedness shall be called the Total Indebtedness (the "Total Indebtedness"). All payments to you or withdrawals by you hereunder shall be applied to the MK Indebtedness and the Duck Indebtedness in an amount equal to the percentage each bears to the Total Indebtedness; provided, however, the $80,000 payment referred to in Section 3, the

proceeds of sale of the four (4) MK Memberships and one-half (1/2) of the proceeds of sale of the Duck Membership (as defined below) referred to in Section 3 and the Manuel Kaplan ("Mr. Kaplan") tax refunds referred to in Section 4 shall be applied to the MK Indebtedness only.

2. Subordination Agreement and Subordinated Note. MK and Duck agree to execute and deliver to you upon your request, in form and substance satisfactory to you, a subordinated loan agreement (the "Subordinated Loan Agreement") and such other documentation as shall be necessary or appropriate for you to make subordinated loans to MK and Duck in the amount of the MK Indebtedness and Duck Indebtedness, as the case may be, less the payments described in Section 3. In connection with such Subordinated Loan Agreement, MK and Duck each agree to execute and deliver to you a promissory note, in form and substance satisfactory to you, executed by MK or Duck, as the case may be, dated the date of such delivery, and payable to you in a principal amount equal to the amount of the MK or Duck Indebtedness, less the payments described in Section 3. (the "MK Subordinated Note" and the "Duck Subordinated Note", collectively the "Subordinated Notes"). The Subordinated Notes shall be payable on March 31, 1998 (unless sooner accelerated), subject to the mandatory payments hereinafter described. The Subordinated Notes may be prepaid at any time; provided, however, any such prepayment shall comply with the prepayment provisions of the Subordinated Notes. The Subordinated Notes shall contain Events of Acceleration (as defined below) as set forth in the Subordinated Loan Agreement, upon the occurrence and continuance of which all amounts under the Subordinated Notes shall or may at your option, be immediately accelerated. The term "Event of Acceleration" shall have the same meaning in this Agreement as in the Subordinated Loan Agreement.

MK, Duck, Mr. Kaplan and Larry Goldberg ("Mr. Goldberg") agree that MK, Duck, Mr. Kaplan and Mr. Goldberg may not resume trading on the Exchange (hereinafter defined), or any other exchange, until (1) the $80,000 payment provided in Section 3 of this Agreement has been made to you, (2) the Memberships

(hereinafter defined) have been sold to you, (3) you have received duly executed Subordinated Notes and the Subordination Agreement and (4) you have received a schedule of all profit sharing arrangements as required pursuant to Section 9.

3. Initial Payments. MK hereby agrees that within four calendar days of the Effective Date (as defined in Section 17) of the Agreement, MK will deliver to you $80,000 in the form of a cashier's check payable to you in such amount issued by such bank as shall be acceptable to you or in such other form as shall be acceptable to you for application by you toward the payment of the MK Indebtedness.

Within four calendar days of the Effective Date of this Agreement, MK and Duck agree to sell and transfer to you and you agree to purchase from MK and Duck, MK's four (4) and Duck's one (1) Philadelphia Stock Exchange (the "Exchange") Regular Memberships with Options Privileges (the "Memberships") at a price equal to each Membership's Fair Market Value on the date appearing on the first page hereof. "Fair Market Value" means, on the date appearing on the first page hereof, the average of the "bid" and "offer" price for memberships similar to such Membership on the Exchange as reasonably determined by you. You shall apply the sale proceeds of the MK and Duck Memberships, free and clear of any other claims or interests therein, to the MK Indebtedness or Duck Indebtedness, as the case may be as herein provided. Upon the sale of a Membership to you, you agree to lease such Membership to MK and Duck, as the case may be, until such time as this Agreement has been terminated or an Event of Acceleration has occurred and shall be continuing, on terms substantially similar to the terms contained in the lease agreement attached hereto as Exhibit B; provided, however, each such lease shall provide for monthly lease payments in an amount equal to the monthly interest payments for a loan in the principal amount of 70.17 percent (70.17%) of the sale price of such Membership with interest thereon at a rate per annum equal to the Reference Rate from time to time in effect plus two percent (2%) per annum. Each lease shall contain an option to repurchase the appropriate Membership at Fair Market Value upon the

termination of this Agreement; provided however each such option to repurchase as well as such lease shall terminate upon an Event of Acceleration. "Reference Rate" at any time shall mean the rate of interest then most recently announced by Continental Illinois National Bank and Trust Company of Chicago at Chicago, Illinois as its reference rate. The rate of interest shall change from time to time, and hence the lease payments on each such lease described herein shall change from time to time, concurrently with changes in the Reference Rate.

4. Tax Refunds. Mr. Kaplan and Mrs. Carol Kaplan ("Mrs. Kaplan"), his wife, shall file (or cause to be filed) all necessary documents to obtain all tax refunds (including but not limited to, income tax refunds and estimated tax payments) which are now, or which may be or become, due or owing to Mr. Kaplan and/or Mrs. Kaplan from the United States Government or any state or local government. Mr. Kaplan and Mrs. Kaplan will file (or cause to be filed) 1987 federal and state tax returns by June 15, 1988 and promptly deliver copies thereof to you. If Mr. Kaplan does not file federal and state tax refund requests for prior years by October 15, 1988, Mr. Kaplan shall obtain and deliver to you a statement of his accountant that the amount of federal and state tax refunds for prior years does not exceed $150,000. Upon receipt of any and all tax refunds, Mr. Kaplan and Mrs. Kaplan agree to immediately remit the amount of such refunds to you which shall be applied by you to the prepayment of the Total Indebtedness. In the event you shall not have received the full amount of any and all 1987 tax refunds which shall be in an amount of at least $300,000 by February 28, 1989, you may deem such non-payment on February 28, 1989 to constitute an Event of Acceleration; provided, however, such non-payment shall not constitute an Event of Acceleration if it is the result of delays of the applicable tax authority but in any event shall constitute an Event of Acceleration on March 31, 1989.

5. Trading Account and Work Out Program. Within four calendar days of the Effective Date of this Agreement, MK will deposit in a trading account with you (the "Trading Account") immediately available funds in the amount of $900,000, which

shall include MK's entire one-third interest in the profits of DKW currently in account no. 666. MK represents and warrants that such DKW funds are free and clear of all claims or interests therein. Five hundred thousand dollars ($500,000) of such deposit shall be called the MK Allocation (the "MK Allocation"). Four hundred thousand dollars ($400,000) of such deposit shall be called the FOC Allocation (the "FOC Allocation"). To the extent the MK Allocation consists of funds MK or Mr. Kaplan borrowed from any natural or legal person other than Mr. Kaplan or Mrs. Kaplan, such borrowed funds shall be regarded as Senior Liabilities for purposes of the Subordinated Notes. If the MK Allocation consists of funds of Mr. or Mrs. Kaplan, such borrowed funds shall not represent Senior Liabilities for purposes of the Subordinated Notes. The Senior Liabilities shall at all times remain the property of MK and may not be withdrawn by you.

Except as otherwise provided herein, neither MK nor you shall make any withdrawals from the Trading Account and withdrawals shall not reduce the net liquidating balance in the Trading Account below $900,000. Until this Agreement is terminated as provided in Section 7 or an Event of Acceleration shall occur and be continuing, MK and you agree that MK may withdraw from time to time in the aggregate the first $10,000 in Net Trading Profits (as defined below) credited to the Trading Account during any calendar month commencing with the calendar month in which $900,000 is deposited into the Trading Account until such calendar month in which the Agreement is terminated if the MK Allocation is not reduced below $500,000. If MK withdraws such amounts, then you may from time to time withdraw in the aggregate the second $10,000 Net Trading Profits credited to the Trading Account during such calendar month if the FOC Allocation is not reduced below $400,000. MK's rights to withdraw the amounts contemplated herein shall be suspended if any withdrawal would reduce the MK Allocation below $500,000. Such right shall be suspended until such time as the MK Allocation has been restored to $500,000. If MK or you choose not to withdraw such amounts during any calendar month, then the FOC Allocation and the MK Allocation as the case may be, shall be increased in the amount of the foregone withdrawal. If MK or you withdraw such amounts,

it shall reduce the MK Allocation or the FOC Allocation, as the case may be, in the amount of such withdrawal. Any withdrawals by you or MK pursuant to this paragraph shall be included in your respective shares of Net Trading Profits and the withdrawals limits as hereinafter provided. If you withdraw such amounts, you shall apply it to the Total Indebtedness. The term "Net Trading Profits (Losses)" shall mean Gross Trading Revenues minus Operating Expenses. "Gross Trading Revenues" means the sum of realized and unrealized gains and losses from positions traded on any exchange for the time period during which Gross Trading Revenues are being determined plus trading related income, including, without limitation, dividends, cash tenders of stock, short stock rebates plus MK's or Mr. Kaplan's share of all net trading profits from all other profit-sharing arrangements as defined in Section 9. "Operating Expenses" shall mean the following expenses incurred by MK in the operation of its trading business: reasonable compensation to employees and traders, supplies, interest payments on the Senior Liabilities (as hereinafter defined), interest payments on indebtedness permitted by Section 7 of the Subordinated Loan Agreement, interest payments on the FOC Allocation capital and debit balance interest charges, brokerage commissions, exchange dues, regulatory expenses, reasonable medical and term life insurance for Mr. Kaplan and clerical employees of MK, with cash benefits not to exceed $2,000,000 in the case of Mr. Kaplan or $50,000 in the case of clerical employees of MK (in neither case shall it be required that you be a beneficiary of such policies) lease fees, office rent, telephone, postage, quotation machines, reasonable attorneys' and accountants' fees and taxes but excluding any compensation, entertainment expenses, commissions, benefits or other distributions to Mr. Kaplan. "Taxes" for purposes of calculating Operating Expenses shall include all taxes payable by MK as well as taxes of Mr. and Mrs. Kaplan relating to Mr. Kaplan's share of income generated by MK and Duck which flows through to Mr. Kaplan to the extent that tax loss carry forward credits are not available.

Notwithstanding the preceding paragraph, MK may withdraw in the aggregate $10,000 from the Trading Account during each of the first six months of this Agreement regardless of the amount of

the Net Trading Profits therein or if such withdrawals reduce the MK Allocation in the Trading Account below $500,000; provided however if the MK Allocation is not restored to $500,000 at the end of such six month period, no further monthly withdrawals pursuant to this paragraph or the preceding paragraph shall be permitted until the MK Allocation is restored to $500,000. MK may also withdraw from time to time amounts equal to the amount of interest due on that portion of the initial MK Allocation $500,000 which constitute Senior Liabilities (the "Senior Liabilities") for purposes of the Subordinated Notes; provided, however, the Senior Liabilities may not bear interest at a rate per annum greater than the rate of the Reference Rate per annum plus two percent (2%) per annum. In addition, you recognize the provisions of the trading agreements entered into by MK as of the date hereof with Edward Sneiderman, Eric Bryant, Sherman Frager, Nick DeCicco and Michael Garner and the agreement between Duck and Jules Meisel, and you agree to permit withdrawals to such parties in accordance with the terms of such agreements.

Moreover, at the end of each year (or portion thereof) during the First Payment Stage (as defined below) commencing on December 31, 1988 and continuing until such First Payment Stage is completed, and to the extent that Net Trading Profits credited to the Trading Account during such year (or portion thereof) do not in the aggregate exceed the Base Amount (as defined below), then MK and you shall share all the Net Trading Profits equally. To the extent that the aggregate Net Trading Profits credited to the Trading Account during such year (or portion thereof) exceed the Base Amount (as defined below), then you and MK shall be entitled to 75% and 25%, respectively, of the Net Trading Profits credited to the Trading Account over the Base Amount.

All Net Trading Losses during the First Payment Stage (as defined below) or the Second Payment Stage (as defined below) shall be shared equally and shall reduce the FOC Allocation and MK Allocation accordingly; provided, however, you shall not share in any Net Trading or Losses at any time after which the FOC Allocation has been reduced to zero.

If you or MK choose not to withdraw your respective shares of the Net Trading Profits at the end of such year (or portions thereof) during the First Payment Stage (as defined below), then the MK Allocation or the FOC Allocation, as the case may be, shall be increased in the amount of MK's or your share of Net Trading Profits. If you choose to withdraw any share of your Net Trading Profits at the end of such year (or portion thereof) or any time thereafter whether during or after the Second Payment Stage, then you shall immediately apply such amount to the Total Indebtedness; provided, however, you may not withdraw more than 50% of your share of the Net Trading Profits at the end of any year (or portion thereof) during the First Payment Stage and the amounts required to be retained in the Trading Account shall increase the Base Amount (as defined below). If you plan to withdraw such amounts at the end of such year (or portion thereof) or at any time thereafter whether during the First or Second Payment Stage, you shall give MK thirty (30) days prior written notice of such choice; provided, however, such notice is not required if MK has withdrawn its share of the Net Trading Profits first in time. If MK chooses to withdraw any share of its Net Trading Profits, then the MK Allocation shall not be increased by the amount withdrawn; provided however, MK may not withdraw more than 50% of its share of Net Trading Profits at the end of such year (or a portion thereof) and the amounts required to be retained in the Trading Account shall increase the Base Amount (as defined below). The Base Amount (as defined below) may not be withdrawn during the First Payment Stage except as otherwise provided in Sections 5, 7 and 10. As used herein, the term "First Payment Stage" shall mean the period of time commencing on the date of this Agreement and continuing until such time as the outstanding principal balance of the Subordinated Notes minus the amount of the FOC Allocation equals $4,267,343. The term "Base Amount" shall mean, during the first year (or portion thereof) of the First Payment Stage, $900,000, and during any subsequent year (or portion thereof) during the First Payment Stage $900,000 plus the amount by which each of the FOC Allocation and MK Allocation have been increased by their portion

of Net Trading Profits which are required to be retained in the Trading Account as provided in this Section 5 of the Agreement.

If the First Payment Stage does not end on or before February 28, 1995 and such delay is the result of the serious illness or physical incapacitation of Mr. Kaplan as defined in Section 10, or the closing of the Exchange, the suspension of options trading or similar event, then you may withdraw the FOC Allocation and MK may withdraw the MK Allocation after liquidating the Trading Account and this Agreement shall terminate as provided in Section 7. If the events described in the preceding sentence are not the cause of such delay, then you may deem an Event of Acceleration to have occurred whereupon you may withdraw the FOC Allocation and so much of the MK Allocation (less Senior Liabilities) until the outstanding principal balance of the Subordinated Notes minus the FOC Allocation equals $4,267,343 and the Agreement shall terminate as provided in Section 7. Notwithstanding Section 6(b), the Subordinated Notes shall not be deemed to have borne interest upon the occurrence of the Event of Acceleration described in the preceding sentence.

At the end of each year (or portion thereof) during the Second Payment Stage (as defined below) until such Second Payment Stage is completed, you may withdraw up to 25% of the Net Trading Profits credited to the Trading Account during such year (or portion thereof); provided, however, at the beginning of each year (or portion thereof) during the Second Payment Stage, MK shall elect whether it shall (i) pay to you $2,150,000 or if any amounts have already been paid to you out of MK withdrawals during the Second Payment Stage, or credited to the FOC Allocation or any combination thereof, MK shall pay to you an amount which when added to such amounts already paid or credited to you during the Second Payment Stage shall equal $2,150,000 or (2) continue to share Net Trading Profits with you as provided in this sentence for that year (or portion thereof); provided, further, if at the end of the Second Payment Stage, you shall not have received $2,150,000, or if the FOC Allocation has not been credited by an amount equal to $2,150,000 or you shall not have received $2,150,000 through any combination thereof, then you may

continue to share Net Trading Profits as provided in this sentence until such time as the FOC Allocation has been increased to $2,150,000, or an amount up to $2,150,000 has been paid to you or you shall have received $2,150,000 through any combination thereof. You may withdraw any part of your 25% share of the Net Trading Profits credited to the Trading Account at the end of each year (or portion thereof) during the Second Payment Stage or at anytime after such year upon giving (thirty) 30 days prior written notice of the date of such withdrawal to MK; provided however, such notice is not required if MK has withdrawn its share of Net Trading Profits first in time. MK may withdraw any part of its 75% share of Net Trading Profits credited to the Trading Account at the end of each year (or portion thereof) during the Second Payment Stage. You may choose not to withdraw your percentage share of Net Trading Profits credited to the Trading Account during the Second Payment Period. In such case, the FOC Allocation shall be increased by the amount of your percentage share of the Net Trading Profits.

The term "Second Payment Stage" shall mean the period commencing on the date the outstanding principal balance of the Subordinated Notes minus the FOC Allocation equals $4,267,343 and ending on the third anniversary date thereof.

If at any time during the Second Payment Stage Net Trading Losses result in the outstanding principal balance of the Subordinated Notes minus the FOC Allocation being greater than $4,267,343, then you and MK shall deem the Second Payment Stage not to have occurred and you and MK shall have the rights and obligations specified during the First Payment Stage until such time as the outstanding principal balance of the Subordinated Notes minus the FOC Allocation again equals $4,267,343, whereupon the Second Payment Stage shall begin.

If at any time during the Second Payment Period only, MK and Mr. Kaplan want to stop trading completely and Mr. Kaplan wants to retire from trading and no longer be actively associated with a broker-dealer in a trading capacity or be an employee thereof in a trading capacity ("Retirement"), then MK shall pay you your share of all amounts earned until the date of Retirement

as provided herein during the Second Payment Stage which shall be applied to the Total Indebtedness and the Agreement shall terminate as provided in Section 7; provided, however, if MK and/or Mr. Kaplan should become actively associated with a broker dealer in a trading capacity or be an employee thereof in a trading capacity within five (5) years of the date of Retirement, then (1) the releases provided in the first paragraph of Section 11 hereof shall be deemed to have never been given; (2) this Agreement shall again be effective and any payment periods provided herein shall be extended by the time equal to the duration of MK's and Mr. Kaplan's absence from trading except that you shall not be required to restore the FOC Allocation; and (3) you shall have all remedies available to you under applicable law.

If after giving thirty (30) days notice of a planned withdrawal as provided herein you are not able to make such withdrawals as a result of the prepayment restrictions contained in Section 5 of the Subordinated Loan Agreement, then no further notice is required and you may make such withdrawals as soon as such withdrawal could be made in compliance with Section 5 of the Subordinated Loan Agreement.

6. (a) Interest Before Event of Acceleration. The FOC Allocation as of the date the Second Payment Stage begins minus $400,000 (or such reduced amount of the FOC Allocation after any withdrawals thereof during the Second Payment Stage) shall bear interest from the date of the Second Payment Stage until the Agreement is terminated at a rate per annum equal to the Reference Rate from time to time in effect plus 2% per annum, payable on the last day of each year (or portion thereof) during the Second Payment Stage and at the termination of this Agreement. Any increases in the FOC Allocation during the Second Payment Stage shall bear interest at the rate specified in the preceding sentence from the date such increase is ascertained until this Agreement is terminated and shall be payable on the last day of each year (or portion thereof) during the Second Payment Stage and at the termination of this Agreement. If any of the leases described in Section 3 hereof have been terminated, then the amount of the FOC Allocation bearing interest during the Second Payment Stage

as provided in this Section 6(a) shall be automatically increased in the amount of _____ percent (%) of the Fair Market Value of the Membership with respect to which the lease was terminated as provided in Section 3. Any interest payable on the FOC Allocation shall be an expense in calculating Net Trading Profits (Losses). MK hereby irrevocably authorizes you to debit the Trading Account in the amount of any interest payments due on the FOC Allocation. If the Trading Account does not have sufficient balances to make the applicable interest payments provided herein, you may deem an Event of Acceleration for non-payment of interest to have occurred and be continuing.

(b) Interest After Event of Acceleration. If an Event of Acceleration shall have occurred, then the Subordinated Notes shall be deemed to have borne interest from the date of the Subordinated Notes at a rate per annum equal to the Reference Rate payable on demand. Any interest required to be paid on the Subordinated Notes shall be reduced by any interest amounts already paid by MK on the FOC Allocation during the Second Payment Stage, as provided in Section 6(a), and the amounts paid as rent in connection with MK's or Duck's lease of the Memberships as provided in Section 3. If an Event of Acceleration shall have occurred and be continuing, the FOC Allocation (as limited herein) and/or the outstanding principal balance of the Subordinated Notes shall continue to bear interest at the rate per annum specified in Section 6a).

7. Termination. If no Event of Acceleration has occurred and is continuing and (i) the outstanding principal balance of the Subordinated Notes after deeming that the FOC Allocation has been applied thereto at most equals $2,117,343,; or (2) Mr. Kaplan and MK have retired from trading during the Second Payment Stage as provided in Section 5; or (3) Mr. Kaplan has died during the Second Payment Stage; or (4) the Agreement is terminated on March 31, 1995 as provided in Section 5; or (5) Mr. Kaplan is seriously ill or physically incapacitated as provided in Section 10; then you may withdraw from the Trading Account the amount of the FOC Allocation notwithstanding Section 5. Upon such withdrawal, this Agreement, the Subordinated Notes and any

other documents referred to herein shall terminate, except that the provisions of Section 9 shall not terminate if this Agreement is otherwise terminated because of Mr. Kaplan's serious illness or physical incapacitation. You shall also deliver to each of MK and Duck a release from their obligations to you under the Subordinated Notes and other documents provided herein as provided in Section 11, whereupon MK and Duck shall have no further liability to you with respect to the obligations originally subject to this Agreement, the Subordinated Notes and any other documents referred to herein.

In the event any payments provided for herein are not made when due or if the Subordinated Notes are accelerated, then you may apply payments received by you, the FOC Allocation and the MK Allocation (less Senior Liabilities) to the Total Indebtedness and the outstanding principal balance thereof shall remain due and owing.

8. Clearing Arrangements. To the extent permitted by applicable law, Mr. Kaplan, Mr. Goldberg, Duck and MK agree neither to open nor maintain, directly or indirectly, whether by, through or in the name of, including without limitation, MK, Duck, OI, Mr. Kaplan or Mr. Goldberg or any other person, corporation, partnership, limited partnership, general partnership, nominee, agent, spouse or other entity, any trading account at any clearing firm, broker-dealer or other entity or at First Options of Chicago, Inc. other than the Trading Account or Duck trading account and they further agree not make or to continue arrangements with any other entity to execute and clear trades nor to self-execute and self-clear trades, without prior written consent from First Options of Chicago, Inc. until such time as the Total Indebtedness and Subordinated Notes are satisfied or released by you; provided, however, Mr. Kaplan and Mr. Goldberg need not obtain prior written consent from you when opening personal investment accounts or KEOGH accounts.

You agree that all clearing fees, commissions and other charges to be paid by MK to you in connection with the Trading Account or other services performed by you for MK shall be competitive with those of other clearing firms performing similar

services for customers similarly situated and which desire to continue to serve such a customer. In the event MK disputes the competitiveness of such fees, MK and you may select one arbitrator each and such arbitrators shall unanimously decide what fees are competitive and such unanimous decision shall be binding on the parties. If such arbitrators are unable to agree, they shall select a third arbitrator within thirty days and their majority decision shall be binding on the parties.

9. Other Profit-Sharing Arrangements. Under the terms of this Agreement, MK is required to make payments to you from any Net Trading Profits earned by MK and credited to the Trading Account. Such "Net Trading Profits" shall include MK's or Mr. Kaplan's share of any net trading profits credited to the Trading Account at First Options of Chicago, Inc. or any other trading account with First Options of Chicago, Inc. or at any other entity of any person, corporation, partnership, limited partnership, general partnership, nominee, agent, spouse or other entity (including MK's share of Duck) directly or indirectly owned, or controlled by MK and Mr. Kaplan and MK and Mr. Kaplan agree to remit or cause such entity to remit to First Options of Chicago, Inc. such net trading profits in excess of the amount of Net Trading Profits which could have been withdrawn by MK pursuant to the provisions of Section 5. Such remitted net trading profits shall be allocated to the FOC Allocation or the MK Allocation as contemplated by Section 5. If such Net Trading Profits are not remitted to the Trading Account directly or your share is not paid directly to you as provided in this Section 9, then you may deem the failure of such remittance to be an Event of Acceleration for non-payment to be continuing.

MK and Mr. Kaplan agree to disclose in writing and deliver any documents evidencing any profit sharing arrangements with any other natural or legal person. MK and Mr. Kaplan represent and warrant that such disclosed profit sharing arrangements constitute all such arrangements and that MK and Mr. Kaplan shall disclose any additional profit sharing arrangements entered into in the future. A breach of the representations and

warranties contained in this Section 9 shall constitute an Event of Acceleration.

10. Illness or Death. If at anytime Mr. Kaplan is unable to trade on the Exchange because of serious illness (including without limitation, blindness, heart attack, stroke, cancer A.I.D.S. or similar illness) or physical incapacitation for a continuous period of six months, as evidenced by the written opinion of two medical doctors selected as herein provided, Mr. Kaplan or his estate may withdraw the MK Allocation from the Trading Account on such date. Upon such withdrawal, you may also withdraw the FOC Allocation. These withdrawals shall be made notwithstanding Section 5. Any profit sharing arrangements which MK or Mr. Kaplan has with any other entity disclosed pursuant to Section 9 hereunder shall continue to be remitted to the Trading Account until the Maturity Date of the Subordinated Notes, or until this Agreement is terminated if Mr. Kaplan shall stop trading because of serious illness or physical incapacitation only. If Mr. Kaplan should resume trading at any time after stopping trading because of serious illness or physical incapacitation as provided herein, then (1) this Agreement shall again become effective and any payment periods provided herein shall be extended by an amount equal to the duration of Mr. Kaplan's absence from trading, except that you shall not be required to restore the FOC Allocation; (2) the releases provided in the first paragraph of Section 11 shall be deemed to have never been given; and (3) you shall have all remedies available to you under applicable law. If Mr. Kaplan dies at any time during the Second Payment Stage this Agreement shall terminate as provided in Section 7.

You and MK shall have the right to select one doctor each for the purposes of the opinion required herein. If such two doctors cannot agree on an opinion of the capacity of Mr. Kaplan to trade on the Exchange, then such doctors shall select a third doctor within 5 days and the majority opinion shall prevail. If Mr. Kaplan dies during the Second Payment Stage, his executor shall select a trader reasonably acceptable to you within 30 days to liquidate the Trading Account, provided, however, until such time as such trader is selected, you shall have the right to liquidate

positions in the Trading Account to keep the Trading Account in compliance with your risk guidelines applicable to such accounts.

11. Releases. Upon termination of this Agreement, the release of or payment in full of the Subordinated Notes and other valuable consideration, receipt and sufficiency of which is hereby acknowledged, you and your subsidiaries do hereby forever release, discharge, waive and forgive all manner of actions, causes, causes of action, suits, accounts, reckonings, controversies, damages, claims, demands, costs, expenses and other liabilities of any kind whatsoever, in law or in equity, which you or your subsidiaries may now have, or which you or your subsidiaries ever had, or which their respective successors or assigns, hereafter ever shall or may have against MK and Duck, and their respective successors, and assigns, for, upon or by reason of any activities relating to the Total Indebtedness, including the payment thereof, in the following accounts: 420; 356; 468; 673; 551; 557; 956; 667; 336; MKB; 398; 428; 350; 388; 434; XIB; and 445 on or at any time prior to the date of the signing of this Agreement.

In consideration of your accepting the Subordinated Notes, the sufficiency of which is hereby acknowledged, MK, Mr. Kaplan, Duck, Mr. Goldberg, OI, Mrs. Kaplan, Ed Manfield, Binary Traders, Isabelle Benton and their respective successors, assigns, heirs and legal representatives (collectively the "MK parties") do hereby forever release, discharge, waive and forgive all actions, causes of action, suits, accounts, reckonings, controversies, damages, claims, demands, costs, expenses and other liabilities whatsoever, in law or in equity, however arising, which the MK parties may now have, may have ever had, or which the MK parties ever may have against you and your subsidiaries or your parent and subsidiary corporations and their respective agents, officers, directors and employees and their respective successors, assigns, heirs or legal representatives upon or by reason of any activities relating to the Total Indebtedness, including the payment thereof, in the following accounts 420; 356; 468; 673; 551; 557; 956; 667; 336; MKB; 398; 428; 350; 388; 434; XIB; and 445 on or at any time prior to the date of signing this Agreement; provided however, with respect to your agents, officers, directors

and employees or any of your subsidiaries, parent and subsidiary corporations or their respective successors, assigns, heirs and legal representatives, such release shall only apply to matters arising under or in connection with transactions with you.

You and your subsidiaries do hereby forever release, discharge, waive and forgive all actions, causes, of action, suits, accounts, reckonings, controversies, damages, claims, demands, costs, expenses and other liabilities of any kind whatsoever, in law or in equity, which you or your subsidiaries may now have, or which you or your subsidiaries ever had, or which their respective successors or assigns, hereafter ever may have against Mr. Kaplan, Larry Goldberg, Ed Manfield, Binary Traders, Isabelle Benton and OI and their respective successors, and assigns, for, upon or by reason of any activities relating to the Total Indebtedness, including the payment thereof, in the following accounts: 420; 356; 468; 673; 551; 557; 956; 667; 336; MKB; 398; 428; 350; 388; 434; XIB; and 445 on or at any time prior to the date of the signing of this Agreement; provided, however, you and your subsidiaries do not release Mr. Kaplan or Larry Goldberg from complete performance of the terms of this Agreement and other documents contained herein and applicable to them.

12. Successors and Assigns. This Agreement shall be binding upon the successors and assigns of MK, Duck, Mr. Goldberg, Mr. Kaplan and First Options of Chicago, Inc.; and, all references herein to MK, Duck and First Options of Chicago, Inc. shall be deemed to include any successor or successors, whether immediate or remote, to such corporations. Mrs. Kaplan is signing this agreement to evidence her agreement to sign all documents necessary to fulfill the terms of this agreement applicable to her. Binary Trading, Ed Manfield and Isabelle Benton are signing this Agreement for purposes of the release contained in Section 11 of this Agreement only.

13. Guaranties. For value received, the sufficiency of which is hereby acknowledged, Mr. Kaplan in his individual capacity does personally and unconditionally agree to fully and promptly perform at all times those aspects of this Agreement (such as Sections 3 and 4) which are specifically required by him to be

performed and which are within his control and to use his best efforts to cause to be performed promptly by MK those aspects of this Agreement, the Subordinated Notes, the Guaranty or any other documents referred to herein required by MK to be performed, provided, however, this performance guaranty of certain actions is not a guaranty of the payment of the Indebtedness of MK, Duck or OI.

14. John Maeder. Concurrently with the execution of this document, there shall be executed a settlement agreement between you, BTD, Inc. and John Maeder which shall provide among other things, that upon the signing of such agreement you shall release BTD, Inc. from its guaranty of the obligations of MK and that you shall release MK from its guaranty of BTD, Inc.

15. Books and Records. You shall establish and maintain the Trading Account and any other account and monitor the books and records concerning the Trading Account or any other account or for any other service contemplated in this Agreement. You shall approve (not to be unreasonably withheld) all distributions, credits or withdrawals or any other matters concerning the Trading Account, any Duck accounts or any other accounts maintained at First Options of Chicago, Inc., by the parties hereto.

MK shall make available during normal business hours for inspection by FOC or its duly authorized representatives any of its books and records of the trading business when reasonably requested by FOC to do so, and furnish FOC any information reasonably requested regarding the trading business within a reasonable time after FOC gives notice of its request therefor. MK shall permit, during normal business hours, representatives of FOC to audit the books and records of the trading business; provided, however, that FOC shall bear the cost and expense of any audit.

16. Law. This Agreement shall be governed by the laws of the State of Illinois.

17. Effective Date. This Agreement, the Subordinated Notes, the Subordinated Loan Agreement, the Guaranty and all other documents referred to herein shall become effective on the

date that you shall notify the parties hereto that you have received telephone or other approval of an outline of the terms of this Agreement from the Office of the Comptroller of the Currency or other appropriate regulatory agencies, provided however such approval shall be obtained within fourteen (14) calendar days of the execution of this Agreement.

Very truly yours,

MK INVESTMENTS, INC.

By: Manuel Kaplan [sig.]

Title: President

Manuel Kaplan [sig.]
Manuel Kaplan, in his individual capacity

[Notarized]

Carol Kaplan [sig.]
Carol Kaplan, in her individual capacity

DUCK BROTHERS, INC.

By: Larry Goldberg [sig.]

Title: President

Larry Goldberg [sig.]
Larry Goldberg, in his individual capacity

OPTIONS INVESTORS, INC.

By: I. Isabelle Benton [sig.]

Title: President

BINARY TRADERS

By: Edward A. Manfield [sig.]

Title: General Partner

Edward A. Manfield [sig.]
Ed Manfield, in his individual capacity

Isabelle Benton [sig.]
Isabelle Benton, in her individual capacity

Accepted this 24th day of March 1988.

FIRST OPTIONS OF CHICAGO, INC.

By: [sig.]

Title: V.P.

EXHIBIT A

GUARANTY

FOR VALUE RECEIVED and in consideration of any subordinated, loan or other financial accommodation heretofore or hereafter at any time made or granted to DUCK BROTHERS, INC., a corporation organized and existing under the laws of Pennsylvania (hereinafter called the "Debtor") by FIRST OPTIONS OF CHICAGO, INC. (hereinafter, together with its successors and assigns, called "FOC"), the undersigned hereby unconditionally guarantees the full and prompt payment when due, whether by acceleration or otherwise, and at all times thereafter, of that certain Subordinated Note dated March 24, 1988 (the "Subordinated Note") of the Debtor payable to FOC in the original principal amount of $2,307,498 subject to the terms of that certain Letter Agreement dated March 24, 1988 (the "Letter Agreement") between the undersigned, the Debtor the other signatories thereto and FOC (all such obligations being hereinafter collectively called the "Liabilities"), and the undersigned further agrees to pay all expenses (including attorneys' fees and legal expenses) paid or incurred by FOC in endeavoring to collect the Liabilities, or any part thereof, and in enforcing this guaranty. The right of recovery against the undersigned under this guaranty is, however, limited to the amount of TWO MILLION THREE HUNDRED SEVEN THOUSAND FOUR HUNDRED NINETY EIGHT AND NO/100 DOLLARS ($2,307,498) plus interest on such amount and all expenses of enforcing this guaranty. The limitation of the amount of FOC's right of recovery against the undersigned for the Liabilities of the Debtor as provided herein shall in no manner adversely affect, limit or otherwise impair FOC's right of recovery under any other guaranty of the Debtor's Liabilities given in favor of FOC by any other party.

The undersigned agrees that, in the event of the dissolution or insolvency of the Debtor or the undersigned, or the inability of the Debtor or the undersigned to pay debts as they mature, or an assignment by the Debtor or the undersigned for the benefit of creditors, or the institution of any proceeding by or against the

Debtor or the undersigned alleging that the Debtor or the undersigned is insolvent or unable to pay debts as they mature, and if such event shall occur at a time when any of the Liabilities may not then be due and payable, the undersigned will pay to FOC forthwith the full amount which would be payable hereunder by the undersigned if all Liabilities were then due and payable.

To secure all obligations of the undersigned hereunder and subject to the terms of the Letter Agreement, FOC shall have a lien upon and security interest in (and may, without demand or notice of any kind, at any time and from time to time when any amount shall be due and payable by the undersigned hereunder, appropriate and apply toward the payment of such amount, in such order of application as FOC may elect) any and all balances, credits, deposits (general or special, time or demand, provisional or final), accounts or moneys of or in the name of the undersigned now or hereafter with FOC and any and all property of every kind or description of or in the name of the undersigned now or hereafter, for any reason or purpose whatsoever, in the possession or control of, or in transit to, FOC or any agent or bailee for FOC, except for the MK Allocation.

This guaranty shall in all respects be a continuing, absolute and unconditional guaranty, and shall remain in full force and effect (notwithstanding, without limitation, the dissolution of the undersigned) until such time as the Subordinated Notes (as defined in the Letter Agreement) have been paid in full or the Letter Agreement is terminated as provided therein.

The undersigned further agrees that, if at any time all or any part of any payment theretofore applied by FOC to any of the Liabilities is or must be rescinded or returned by FOC for any reason whatsoever (including, without limitation, the insolvency, bankruptcy or reorganization of the Debtor), such Liabilities shall, for the purposes of this guaranty, to the extent that such payment is or must be rescinded or returned, be deemed to have continued in existence, notwithstanding such application by FOC, and this guaranty shall continue to be effective or be reinstated, as the case may be, as to such Liabilities, all as though such application by FOC had not been made.

Subject to the terms of the Letter Agreement, FOC may, from time to time, whether before or after any discontinuance of this guaranty, at its sole discretion and without notice to the undersigned, take any or all of the following actions: (a) retain or obtain a security interest in any property to secure any of the Liabilities or any obligation hereunder, (b) retain or obtain the primary or secondary obligation of any obligor or obligors, in addition to the undersigned, with respect to any of the Liabilities, (c) extend or renew for one or more periods (whether or not longer than the original period), alter or exchange any of the Liabilities, or release or comprise any obligation of the undersigned hereunder or any obligation of any nature of any other obligor with respect to any of the Liabilities, (d) release its security interest in, or surrender, release or permit any substitution or exchange for, all or any part of any property securing any of the Liabilities or any obligation hereunder, or extend or renew for one or more periods (whether or not longer than the original period) or release, compromise, alter or exchange any obligations of any nature of any obligor with respect to any such property, and (e) resort to the undersigned for payment of any of the Liabilities, whether or not FOC (i) shall have resorted to any property securing any of the Liabilities or any obligation hereunder or (ii) shall have proceeded against any other obligor primarily or secondarily obligated with respect to any of the Liabilities (all of the actions referred to in preceding clauses (i) and (ii) being hereby expressly waived by the undersigned).

Any amounts received by FOC from whatsoever source on account of the Liabilities may be applied by it toward the payment of such of the Liabilities, and in such order of application, as FOC may from time to time elect, subject to the terms of the Letter Agreement.

Until such time as this guaranty shall have been discontinued as to the undersigned and FOC shall have received payment of the full amount of all Liabilities and of all obligations of the undersigned hereunder or until the Letter Agreement is terminated, no payment made by or for the account of the undersigned pursuant to this guaranty shall entitle the undersigned by subrogation or

otherwise to any payment by the Debtor or from or out of any property of the Debtor and the undersigned shall not exercise any right or remedy against the Debtor or any property of the Debtor by reason of any performance by the undersigned of this guaranty.

Subject to the terms of the Letter Agreement, the undersigned hereby expressly waives: (a) notice of the acceptance by FOC of this guaranty, (b) notice of the existence or creation or non-payment of all or any of the Liabilities, (c) presentment, demand, notice of dishonor, protest, and all other notices whatsoever, and (d) all diligence in collection or protection of or realization upon the Liabilities or any part thereof, any obligation hereunder, or any security for, or guaranty of, any of the foregoing.

The creation or existence from time to time of Liabilities in excess of the amount to which the right of recovery under this guaranty is limited is hereby authorized, without notice to the undersigned and shall in no way affect or impair the rights of FOC and the obligations of the undersigned under this guaranty.

Subject to the terms of the Letter Agreement, FOC may, from time to time, whether before or after any discontinuance of this guaranty, without notice to the undersigned, assign or transfer any or all of the Liabilities or any interest therein; and, notwithstanding any such assignment or transfer or any subsequent assignment or transfer thereof, such Liabilities shall be and remain Liabilities for the purposes of this guaranty, and each and every immediate and successive assignee or transferee of any of the Liabilities or of any interest therein shall, to the extent of the interest of such assignee or transferee in the Liabilities, be entitled to the benefits of this guaranty to the same extent as if such assignee or transferee were FOC; provided, however, that, unless FOC shall otherwise consent in writing, FOC shall have an unimpaired right, prior and superior to that of any such assignee or transferee, to enforce this guaranty, for the benefit of FOC, as to those of the Liabilities which FOC has not assigned or transferred.

The undersigned hereby warrants to FOC that the undersigned now has, and will continue to have independent means of obtaining information concerning the affairs, financial condition and business

of the Debtor. FOC shall not have any duty or responsibility to provide the undersigned with any credit or other information concerning the affairs, financial condition or business of the Debtor which may come into FOC's possession.

No delay on the part of FOC in the exercise of any right or remedy shall operate as a waiver thereof, and no single or partial exercise by FOC of any right or remedy shall preclude other or further exercise thereof or the exercise of any other right or remedy; nor shall any modification or waiver of any of the provisions of this guaranty be binding upon FOC except as expressly set forth in a writing duly signed and delivered on behalf of FOC. No action of FOC permitted hereunder shall in any way affect or impair the rights of FOC and the obligations of the undersigned under this guaranty. For the purposes of this guaranty, Liabilities shall include all obligations of the Debtor to FOC, notwithstanding any right or power of the Debtor or anyone else to assert any claim or defense as to the invalidity or unenforceability of any such obligation, and no such claim or defense shall affect or impair the obligations of the undersigned hereunder. The obligations of the undersigned under this guaranty shall be absolute and unconditional irrespective of any circumstance whatsoever which might constitute a legal or equitable discharge or defense of the undersigned. The undersigned hereby acknowledges that there are no conditions to the effectiveness of this guaranty, except for the signing of the Letter Agreement and the Subordinated Loan Agreement.

This guaranty shall be binding upon the undersigned, and the successors and assigns of the undersigned; and to the extent that the Debtor or the undersigned is either a partnership or a corporation, all references herein to the Debtor and to the undersigned, respectively, shall be deemed to include any successor or successors, whether immediate or remote, to such partnership corporation.

This guaranty has been delivered at Chicago, Illinois, and shall be construed in accordance with and governed by the laws of the State of Illinois. Wherever possible, each provision of this guaranty shall be interpreted in such manner as to be effective and

valid under applicable law, but if any provision of this guaranty shall be prohibited by or invalid under such law, such provision shall be ineffective to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or the remaining provisions of this guaranty.

The undersigned hereby expressly waives any right to a trial by jury in any action or proceeding to enforce or defend any rights (i) under this guaranty or under any amendment, instrument, document or agreement delivered or which may in the future be delivered in connection herewith or (ii) arising from any relationship existing in connection with this guaranty, and agrees that any such action or proceeding shall be tried before a court and not before a jury.

In the event of any conflict between the terms of the guaranty and the Letter Agreement or the Subordinated Loan Agreement the terms of the Letter Agreement or the Subordinated Loan Agreement, as the case may be, shall control in all respects.

SIGNED AND DELIVERED this 24th day of March, 1988.

MK INVESTMENTS, INC.

By: Manuel Kaplan [sig.]

Title: President

[Notarized]

SUBORDINATED LOAN AGREEMENT

This Agreement is made this 24th day of March, 1988 between First Options of Chicago, Inc., a Delaware corporation ("FOC"), MK Investments, Inc., a Pennsylvania corporation ("MK") and Duck Brothers, Inc., a Pennsylvania corporation ("Duck") (collectively the "Borrowers").

1. Indebtedness. MK is presently indebted to FOC in the aggregate amount of $6,227,188 as a result of its trading activities with FOC (the "MK Indebtedness"). Duck is presently indebted to FOC in the aggregate amount of $2,307,498 as a result of its trading activities with FOC (the "Duck Indebtedness"). The amount of the MK Indebtedness plus the amount of the Duck Indebtedness shall equal a sum referred to as the Total Indebtedness (the "Total Indebtedness").

2. Repayment Schedule. Subject to the terms and conditions set forth herein, the Borrowers promise to pay to FOC or its assigns the amount of the Total Indebtedness subject to that certain Letter Agreement dated March 24, 1988 (the "Letter Agreement") from the Borrowers and the other parties thereto and FOC, which is incorporated herein and made a part hereof.

3. Subordination. The principal amount loaned to the Borrowers by FOC pursuant to the provisions of this Agreement is extended to convert an existing deficit in the Borrowers' trading accounts with FOC under arrangements whereby such borrowing will be subordinate to the indebtedness of the Borrowers to other creditors, which loans shall be subject in all respects to the risks of Borrowers' business as it is now or hereafter conducted.

FOC irrevocably agrees for itself and its assigns that the obligations of the Borrowers under this Agreement with respect to the payment of principal and interest are and shall be subordinate in right of payment and subject to the prior payment or provision for payment in full of all claims of all other present and future creditors of Borrowers arising out of any matter occurring prior to the due date of any payment obligation under the Letter Agreement or Subordinated Notes (hereinafter defined) and that,

in the event of any receivership, insolvency, bankruptcy, assignment for the benefit of creditors, or any other marshalling of the assets and liabilities of any Borrower, the holder hereof shall not be entitled to participate or share, ratably or otherwise, in the distribution of the assets of such Borrower until all claims of all other present and future creditors of such Borrower arising out of any matter occurring prior to the due date of any payment obligation under the Letter Agreement or Subordinated Notes (hereinafter defined) have been fully satisfied, or provision has been made therefor.

4. Notes. The Borrowers' obligation under this Agreement to pay FOC shall be evidenced by promissory notes in the form of Exhibit A-1 and A-2 attached hereto (the "Subordinated Notes"), which notes shall bear on their face a legend in substantially the following form:

> This Subordinated Note is issued subject to the provisions of a Subordinated Loan Agreement dated March 24, 1988, between First Options of Chicago, Inc., MK Investments, Inc. and Duck Brothers, Inc. and a Letter Agreement dated March 24, 1988 between same parties and others and the terms and conditions of said Subordinated Loan Agreement and Letter Agreement are incorporated herein by reference and made a part hereof.

5. Prepayment. Subject to the condition set forth below, any Borrower may from time to time prepay the Total Indebtedness or any payment due thereof, in whole or in part, without premium or penalty. No such prepayment shall be made at any time when such Borrower's equity in its account at FOC is less than the dollar amount of haircuts which such Borrower is required to take with respect to trading positions maintained by such Borrower and cleared through FOC, as determined by FOC pursuant to the terms of paragraph (c)(2)(x) of Rule 15c3-1 promulgated under the Securities Exchange Act of 1934 (the "Rule"), and no prepayment may be made if such prepayment creates a (c)(2)(x) charge under the terms of the Rule, unless such prepayment is specifically approved by the Philadelphia Stock Exchange, Inc. ("the Exchange") in advance.

6. Modification to Market Maker's Agreement; Exclusive Clearing.

(a) Notwithstanding the terms of the Market Maker Agreements listed on Exhibit B hereto, as any of them may have been from time to time amended, (the "Market Maker Agreements"), such Market Maker Agreements may not be terminated by any Borrower by notice or otherwise, until the Total Indebtedness set forth herein plus interest thereon, if any, is fully paid pursuant the provisions of the Letter Agreement to FOC and FOC acknowledges such payment in writing. At such time, either Borrower may terminate the Market Maker Agreements only pursuant to the terms of such Market Marker Agreements.

(b) Borrowers shall neither make nor continue arrangements with any other organization to execute and clear Borrowers' trades, nor will Borrowers self-execute and self-clear, without the prior written consent of FOC until the Total Indebtedness set forth herein plus interest thereon, if any, if fully paid to FOC and FOC acknowledges such payment in writing or unless FOC releases the Total Indebtedness pursuant to the provisions of the Letter Agreement.

(c) Borrowers agree that notwithstanding the agreement to arbitrate contained herein, the provisions of this Section 6 may be specifically enforced by order of any court of competent jurisdiction, and that this remedy shall be in addition to and not in limitation of all rights and remedies available to FOC under law and under the rules of any securities, options or futures exchange.

7. Covenants. To induce FOC to enter into this Agreement, each Borrower agrees that until the Total Indebtedness and interest thereon, if any, is paid in full as provided in the Letter Agreement or is released, neither Borrower shall without the prior written consent of FOC:

(a) Incur or permit to exist any indebtedness or liability on account of deposits or advances, or for borrowed money or for the deferred purchase price of any property, real or personal, or any services, except (1) liabilities arising in the ordinary course of Borrowers' options trading business maintained on a current basis;

(2) indebtedness outstanding on the date hereof and listed in Exhibit C; (3) loans from Mr. Kaplan to MK or Duck, such loans to be on a status equal to the Total Indebtedness and not having any superior rights than the Total Indebtedness (including without limitation no right to prepayment unless such prepayment would be in compliance with Section 5 hereunder but permitted if such requirements are met); provided, however, such loans may bear interest up to a maximum rate per annum equal to the Reference Rate from time to time in effect plus two percent (2%) per annum and; (4) Senior Liabilities (as defined in the Letter Agreement).

(b) Create, incur, assume or permit to exist any mortgage, pledge, title retention lien or other lien, encumbrance or security interest of any kind with respect to any assets now owned or hereafter acquired.

(c) Become or be a guarantor, or surety of, or otherwise become or be directly or contingently responsible in any manner with respect to any undertaking or obligation of another or make or permit to exist any loans or advances to another or investments in another except MK Investments, Inc. and Duck Brothers, Inc.

8. Events of Acceleration and their Effect. Each of the following shall constitute an Event of Acceleration under this Agreement, the Letter Agreement, the Subordinated Notes, the Guaranty and any other document referred to therein or herein.

(a) Any receivership, insolvency, dissolution, liquidation, bankruptcy, assignment for the benefit of creditors, reorganization whether or not pursuant to bankruptcy laws, or any other marshalling of the assets and liabilities of any Borrower.

(b) Any revocation or suspension for forty-five (45) calendar days or more of either Borrower's trading privileges on, or status as a member of, the Exchange.

(c) Any default of any Borrower in the payment of the principal or any interest payment due hereunder, the Subordinated Notes, the Guaranty, or the Letter Agreement, or any other payment required by the Letter Agreement if such default contin-

ues unremedied for five (5) days after telephonic or written notice thereof shall have been given to each Borrower by FOC.

(d) Any material breach of or failure to perform any covenant made by any Borrower in connection with the execution of this Agreement, the Letter Agreement, the Subordinated Notes, the Guaranty or any other document referred to therein or herein if such material breach or failure shall continue unremedied for ten (10) days after written notice thereof shall have been mailed or delivered to each Borrower by FOC.

(e) If any Borrower shall not be permitted to make any two (2) payments by reason of the restrictions imposed herein pursuant to paragraph (c)(2)(x) of the Rule.

(f) Any judgment being entered against any Borrower in an amount in excess of $250,000 and remaining unsatisfied during any period of 30 days unless during such period such judgment is effectively stayed by appeal or otherwise.

In case of the occurrence of any Event of Acceleration, the unpaid balance of the Total Indebtedness may at FOC's option, to the extent not already due and payable, forthwith mature and become due and payable without presentment, demand, protest or notice of any kind, all of which are hereby waived by the Borrowers. Upon the occurrence of any Event of Acceleration FOC shall have any remedies available to it under applicable law, including without limitation, debting the Trading Account (as defined in the Letter Agreement) in the amount of the balance thereof.

9. Governing Law. This Agreement shall be deemed to have been made under, and shall be governed by, the laws of the State of Illinois in all respects including matters of construction, validity and performance.

10. Arbitration. Except as set forth in Section 6, any controversy arising out of or relating to this Agreement, the Letter Agreement, the Subordinated Notes or any other document referred to herein or therein or the breach thereof shall be submitted to and settled by arbitration pursuant to the Constitution

and Rules of the Exchange. The parties hereto and all who may claim under them shall be conclusively bound by such arbitration.

11. On Whom Binding. This Agreement shall be binding and enforceable in accordance with its terms upon FOC and the Borrowers, and their respective successors and assigns.

12. Conflict. In the event of any conflict between the terms of this Subordinated Loan Agreement and the Letter Agreement, the Letter Agreement shall control in all respects.

13. Notices. Unless otherwise provided herein, any notice required or permitted to be given under this Agreement, the Letter Agreement or the Subordinated Notes or any other document referred to herein or therein shall be sufficiently given if in writing delivered to or sent by certified mail to the appropriate party at the address set forth below, or at any such other address as such party may from time to time specify for that purpose in a notice similarly given.

FOC's Address:

First Options of Chicago, Inc.
One Financial Place
440 South LaSalle Street
Chicago, Illinois 60605
Attention: Mr. Gary Windus

Borrowers' Address:

MK Investments, Inc.
910 Summit Avenue
Penn Valley, Pennsylvania 19072
Attention: Manuel Kaplan,
President

Duck Brothers, Inc.
949 Caledonia Street
Philadelphia, Pennsylvania 19128
Attention: Larry Goldberg,
President

14. Entire Agreement. This Agreement, the Letter Agreement, the Subordinated Notes and any documents referred to herein or therein embody the entire agreement between the parties

and no other evidence of such agreement has been or will be executed without the prior written consent of the Exchange.

Lender: FIRST OPTIONS OF CHICAGO, INC.

By: [sig.]
Title: V.P.

Borrowers: MK INVESTMENTS, INC.

By: Manuel Kaplan [sig.]
Title: President

DUCK BROTHERS, INC.

By: Larry Goldberg [sig.]
Title: President

EXHIBIT A-1

SUBORDINATED PROMISSORY NOTE

$6,227,188

Due: March 31, 1998
Chicago, Illinois: March 24, 1988

The undersigned, for value received, promises to pay to First Options of Chicago, Inc. ("FOC") at 440 South LaSalle Street, Chicago, Illinois 60605 the principal sum of SIX MILLION TWO HUNDRED TWENTY SEVEN THOUSAND ONE HUNDRED EIGHTY-EIGHT AND NO/100 DOLLARS ($6,227,188) payable on March 31, 1998 (the "Maturity Date").

Upon the occurrence of an Event of Acceleration (as defined in the Subordinated Loan Agreement, hereinafter defined), the undersigned further promises to pay to FOC interest on the aggregate unpaid principal amount hereof from time to time outstanding at a rate per annum equal to the Reference Rate in effect from time to time from the date of such Event of Acceleration until paid. Interest shall be computed on the basis of a year consisting of 360 days and paid for actual days elapsed. For purposes of this Subordinated Note, "Reference Rate" means, at any time, the rate of interest then most recently announced by the Continental Illinois National Bank and Trust Company of Chicago, at Chicago, Illinois, as its reference rate. Each change in the interest rate shall take effect on the effective date of the change in the Reference Rate.

THIS SUBORDINATED NOTE IS ISSUED SUBJECT TO THE PROVISIONS OF A SUBORDINATED LOAN AGREEMENT DATED MARCH 24, 1988, BETWEEN FIRST OPTIONS OF CHICAGO, INC., MK INVESTMENTS, INC. AND DUCK BROTHERS, INC. AND A LETTER AGREEMENT DATED MARCH 24, 1988 BETWEEN THE SAME AND OTHER PARTIES AND THE TERMS AND CONDITIONS OF SAID SUBORDINATED LOAN AGREEMENT AND LETTER AGREEMENT ARE INCORPORATED HEREIN BY REFERENCE AND MADE A PART HEREOF.

Address:
910 Summit Avenue
Penn Valley, Pennsylvania 19072
Attention: Manuel Kaplan,
President

MK INVESTMENTS, INC.

By: Manuel Kaplan [sig.]

Title: President

PHILADELPHIA STOCK EXCHANGE, INC.

In the Matter of Arbitration Between First Options of Chicago, Inc. and M.K. Investments, Inc.; Manuel Kaplan; and Carol Kaplan	DECISION

It is hereby determined and decided, after full consideration, that:

1) The Respondents' Motion to Dismiss for Lack of Jurisdiction, dated January 6, 1992, is hereby denied, and

2) The Claimant's Motion to Compel Production of Documents and Information dated January 13, 1992 and December 13, 1991 is hereby slated for oral argument. The date for oral presentation should be mutually agreed upon by the parties, and should be discussed with the Director of Arbitration. This date should be discussed and set upon receipt of this Decision.

Patricia Bird
Chairperson

PHILADELPHIA STOCK EXCHANGE, INC.

In the Matter of Arbitration Between	:	
First Options of Chicago, Inc.	:	
vs.	:	DECISION
MK Investments, Inc.;	:	
Manuel Kaplan; and Carol Kaplan	:	
	:	
	:	

Claimant, First Options of Chicago, Inc. asserted a Statement of Claim against MK Investments, Inc., Manuel Kaplan, and Carol Kaplan which was filed with and received by the Philadelphia Stock Exchange, Inc. on June 21, 1989. Claimant alleged responsibility on part of MK Investments, Inc. in the amount of $6,292,421.60 plus interest, costs and attorneys' fees for the amounts due pursuant to the March 24, 1988 Agreements. Also alleged, under the March 24, 1988 Letter Agreement, was Manuel Kaplan's and Carol Kaplan's liability to Claimamt for the remittance of 1987 state and federal taxation refunds in the approximate amount of $300,000.00 plus interest, costs and attorney's fees. In addition, Claimant alleged personal liability on the part of Manuel Kaplan, in the amount of $6,292,421.60, plus interest, costs and attorneys' fees, on the basis that Mr. Kaplan was a controlling person of MK Investments, Inc. Lastly, Claimant alleged that Manuel Kaplan is the alter ego of MK Investments, Inc. on the basis of Mr. Kaplan's failure to maintain a separate corporate existence and fraud. Claimant seeks $6,292,421.60 plus interest, costs and attorneys' fees with respect to the above allegation.

The Philadelphia Stock Exchange, Inc. received the Respondents' Answers to the Claimant's Statement of Claim on July 24, 1989. By way of her Answer, Carol Kaplan denied Claimant's allegation that she and Manuel Kaplan were under an obligation to assign to the Claimant the 1987 state and federal taxation refund.

Manuel Kaplan, by way of his Answer denied the allegations in Count I of the Statement of Claim and seeks to recover

$600,000.00 plus interest, costs and attorneys' fees. Manuel Kaplan also denied the allegations in Count II of the Statement of Claim and requests the panel to deny the same. As to Count III of the Statement of Claim, Manuel Kaplan denied the same and request the panel for an award for punitive damages in his favor of $1,000,000.00 for injury to his reputation. Manuel Kaplan further denied the allegations in Count IV of the Statement of Claim and requests the panel to enter an award in his favor for the defense of a spurious claim and for punitive damages. Manuel Kaplan further Counterclaimed in the amount of $10,000,000.00 for alleged interference with existing and prospective business opportunities, plus interest, costs and attorneys' fees. In addition, Manuel Kaplan further Counterclaimed in the amount of $10,000,000.00 on the basis of libel and slander, plus interest, costs and attorneys' fees.

MK Investments, Inc. denied the allegations in Counts I - IV of the Statement of Claim and seeks for itself the same remedy as requested by Manuel Kaplan pursuant to this Answer. MK Investments, Inc. further Counterclaimed in the amount of $650,000.00 for breach of contract, plus interest, costs and attorneys' fees. In addition, MK Investments, Inc. Counterclaimed for interference with existing and prospective business opportunities and for libel and slander, each Counterclaim for the amount of $10,000,000.00 plus interest, costs and attorneys' fees.

The arbitrators appointed and confirmed to resolve this matter are the following: Patricia Bird; John Beausang; Thomas Chancler; Harry Green, III; Doris Elwell; Allen Lang; and Elkins Wetherill. The hearings were conducted over eight hearing days, which were held in Philadelphia on the following dates: May 7, 8, 12, 13, 14, 21, 26 and 28, 1992.

After having heard and fully considered the proofs of the parties it is hereby decided and determined as follows:

(1) In favor of First Options of Chicago, Inc. and against MK Investments, Inc. and Manuel Kaplan, jointly and severally, in the amount of five million six hundred sixty-two thousand one hundred eighty-eight dollars

($5,662,188.00) plus interest from January 17, 1989 to the date of satisfaction of the award, the interest to be calculated at the rate of six percent (6%).

(2) In favor of First Options of Chicago, Inc. and against Manuel Kaplan and against Carol Kaplan, jointly and severally, in the amount of three hundred forty-six thousand three hundred forty-two dollars ($346,342.00) plus interest from January 17, 1989 to the date of satisfaction of the award, the interest to be calculated at the rate of six percent (6%).

(3) The Counterclaims of both MK Investments, Inc. and Manuel Kaplan, with respect to the alleged breach of contract, interference with existing and prospective business opportunities, and libel and slander, are denied in their entirety.

(4) The requests of MK Investments, Inc., Manuel Kaplan, and/or Carol Kaplan for attorneys' fees and punitive damages are denied in their entirety.

(5) The request of First Options of Chicago, Inc. for attorneys' fees is denied in its entirety.

(6) The costs associated with this arbitration proceeding are assessed in the following manner:

a. First Options of Chicago, Inc. is to remit to the Philadelphia Stock Exchange, Inc., the amount of four thousand two hundred fifty dollars ($4,250.00). This amount is to be received by the Philadelphia Stock Exchange, Inc. within ten (10) business days from receipt of this decision by the Claimant.

b. MK Investments, Inc., Manuel Kaplan, and Carol Kaplan, jointly and severally, are to remit to the Philadelphia Stock Exchange, Inc. the amount of four thousand two hundred fifty dollars ($4,250.00). This amount is to be received by the Philadelphia Stock

Exchange, Inc. within ten (10) business days from receipt of this decision by the Respondents.

[sig.] 6/5/92
Patricia Bird Dated
Chairperson

AFFIDAVIT OF RICHARD FEDER

Richard Feder, being duly sworn, deposes and says as follows:

1. I am one of the attorneys for Manuel Kaplan, Carol Kaplan and M.K. Investments, Inc. ("the Kaplans") in this matter. Donald Perelman, of this firm, and I represented the Kaplans in all phases of this matter since December, 1991.

2. In a telephone conversation with Lydia Gavalis, the PHLX Director of Arbitration, shortly after the Award in this case was issued, Ms. Gavalis informed me that the Panel held one deliberating session before reaching its decision.

3. At the discovery hearing on January 20, 1992, Mr. Perelman, on behalf of the Kaplans, objected to First Options' refusal to answer basic interrogatories seeking the facts known to First Options that supported its piercing-the-veil allegation. (The interrogatories can be found at R-158.) The Panel denied the objection, stating, "you're asking us to ask him to reveal his case right now and this is not the hearing." The Panel made clear that we would learn First Options' basis at the hearing, and there was no need for us to learn it any sooner.

4. On or about May 21, 1992, we received a letter from Ms. Gavalis enclosing a transcript of First Options' examination of Mr. Kaplan. The letter stated, inter alia: "The transcription was made at the request of the Claimant. No future transcriptions will be made by the PHLX due to the burden related thereto." (R-196)

5. Upon receipt of this letter, I called Ms. Gavalis to inquire about its message. She informed me that First Options' counsel had requested the transcript, that the PHLX had never provided such a service before, and (because of its difficulty) never will do so again.

6. After learning that the Panel had scheduled the hearing to include a Saturday session, I informed Ms. Gavalis, that Mr. Kaplan generally attended synagogue on Saturday mornings, and requested that the Saturday session either be cancelled or delayed

until the afternoon. Ms. Gavalis responded: "Manny will just have to skip synagogue that day."

7. First Options then requested a postponement of the hearing, at the January 20, 1992 discovery hearing. The postponement was granted, and the hearing ultimately was scheduled to include a Friday evening session.

8. I informed Ms. Gavalis that Mr. Kaplan generally attended synagogue on Friday evenings, and requested that the Friday session conclude by 7:30 P.M. Ms. Gavalis denied the request.

_____
Richard Feder

[Notarized]

AFFIDAVIT OF LYDIA GAVALIS

LYDIA GAVALIS, being first duly sworn on oath, deposes and says as follows:

15. I currently am the Director of Arbitration of the Philadelphia Stock Exchange, Inc. ("Exchange"). In February, 1990, my title was Associate Director of Arbitration of the Exchange.

16. On July 24, 1989, in the arbitration proceeding of First Options of Chicago, Inc. v. MK Investments, Inc., Manuel Kaplan and Carol Kaplan, Manuel Kaplan and Carol Kaplan filed their respective objections to the statement of claim of First Options of Chicago, Inc. These objections challenged the jurisdiction of the Exchange over Manuel Kaplan and Carol Kaplan, respectively. Copies of the objections of Manuel Kaplan and Carol Kaplan are attached hereto as Exhibits "A" and "B", respectively.

17. In my role as Associate Director of Arbitration, on February 26, 1990 I attended a pre-hearing conference in the aforementioned arbitration proceeding. At this pre-hearing conference, Thomas Zielinsky, then-counsel for Manuel Kaplan and Carol Kaplan, withdrew his clients' objections to jurisdiction filed on July 24, 1989. In light of the withdrawal of these objections, the arbitrators' decision dated February 27, 1990 did not address the jurisdictional objections of Manuel Kaplan and Carol Kaplan. A copy of the February 27, 1990 Decision is attached hereto as Exhibit "C".

18. On January 6, 1992, the Motion and Supporting Memorandum of Respondents Manuel Kaplan and Carol Kaplan to Dismiss for Lack of Jurisdiction was filed with the Exchange. A copy of this Motion and Supporting Memorandum is attached hereto as Exhibit "D". In this Motion and Supporting Memorandum, Manuel Kaplan and Carol Kaplan again challenged the Exchange's jurisdiction over them. On January 14, 1992, the Arbitration Panel rendered a decision denying the Kaplans' January 6, 1992 Motion to Dismiss for Lack of Jurisdiction. A copy of the January 14, 1992 Decision is attached hereto as Exhibit "E".

19. On May 28, 1992, after closing arguments by the parties and at the conclusion of the hearing on the merits as per normal Exchange procedure, Patricia Bird, Panel Chairperson, stated as follows, "Before I declare this hearing closed will you affirm that all your evidence is in and that you have had an equal opportunity to be heard." Stephen P. Bedell, counsel for First Options, affirmed that all of First Options' evidence was in and that it had an equal opportunity to be heard. Mr. Perelman, counsel for MK Investments, Inc., Mr. Kaplan and Mrs. Kaplan (the "MK parties"), affirmed that, except for a submission of documents requested by the Panel regarding a specific trade concerning Federated Department Stores ("FDS") in MK Investments, Inc.'s account, all of his clients' evidence was in and that his clients had received an equal opportunity to be heard. The MK parties' additional documents concerning the FDS trade were received by the Exchange on June 2, 1992.

20. Michael Waber, a business associate of Mr. Kaplan's at the Exchange, was appointed to the Arbitration Panel in November 1991 but was removed in December 1991. On approximately December 20, 1991, I spoke with Mr. Bedell about the February 26, 1990 discovery order, and indicated that Mr. Waber participated on the Arbitration Committee that entered that order. Mr. Bedell registered an informal objection to Mr. Waber's participation therein and indicated a desire to file a formal objection with the Arbitration Panel. I indicated that the new Panel would be reviewing that order sua sponte for possible vacatur in light of Mr. Waber's participation. On January 10, 1992, the Arbitration Panel sua sponte vacated the February 26, 1990 discovery order.

21. By telecopy letter dated April 28, 1992, First Options' counsel requested the Panel to allow the telephone testimony of William Noble, J. Gary Windus, Jennet Lingle and/or Pat Moran. A copy of this letter is attached hereto as Exhibit "F". Counsel for the MK parties responded to this request by telecopy letter also dated April 28, 1992. A copy of this letter is attached hereto as Exhibit "G". I informed the parties by letter dated April 30, 1992 of the Panel's determination that "any witness may testify via teleconference call." A copy of my April 30, 1992 letter is

attached hereto as Exhibit "H". It is not unusual for an Exchange arbitration panel to allow telephonic testimony.

22. The arbitration hearing of this matter originally was scheduled to be held on November 15, 16 and 18, 1991. The hearing was subsequently rescheduled to January 16, 17, 18 and 20, 1992; then February 13, 14, 15 and 17, 1992; then April 8, 9, 10 and 11, 1992; then May 7, 8, 12 and 13, 1992. When the hearing had been set for November 1991, January 1992, February 1992, and April 1992, Saturday sessions had been scheduled.

23. Prior to the final continuance to May 1992, the MK parties' co-counsel, Richard Feder, requested that no Saturday hearings be held so that Mr. Kaplan could attend synagogue. I indicated to Mr. Feder that the rules allowed parties to appear by counsel and that Mr. Kaplan could choose to appear in person or by counsel at any Saturday sessions. I never stated to Mr. Feder that "Manny will just have to skip synagogue that day." The hearing was later rescheduled for Thursday, May 7, 1992; Friday, May 8, 1992; Tuesday, May 12, 1992; and Wednesday, May 13, 1992. No Saturday hearing sessions were held in this matter.

24. After the hearing was set for the May 1992 dates set forth above, Mr. Feder asked that any Friday sessions be concluded by 7:30 p.m. This request was denied by the Exchange after consultation with the panel chairperson and the general counsel for the Exchange. One Friday hearing session was held in this matter; on Friday, May 8, 1992.

25. At the January 20, 1992 pre-hearing conference, the parties by agreement requested that the hearing be rescheduled to early April 1992.

26. The Exchange interprets its rules to require that awards entered in member controversies require only the certification of the decision by the chairperson of the Arbitration Panel, not the signatures of all arbitrators concurring in the award. This interpretation is based on Section 37(a) of Rule 950 of the Board of Governors of the Philadelphia Stock Exchange which states:

> All awards shall be in writing and signed by a majority of the arbitrators or in such manner as is required by applicable law with respect to public controversies. With respect to member controversies, the Chairman of the panel will certify the decision of the panel in writing. Such awards may be entered as a judgment in any court of competent jurisdiction.

The provision of Section 37(a) requiring written certification by the Panel's chairperson with respect to member controversies is deemed to supersede the provision of Section 37(e) requiring that awards include the signatures of the arbitrators concurring therein, which is deemed to apply only to awards rendered with respect to public controversies.

27. The arbitration proceeding between First Options and the MK parties was a "member controversy".

IN WITNESS WHEREOF, I have set my hand and affixed the seal of the corporation this 31st day of July, 1992.

LYDIA GAVALIS

[Notarized]

AFFIDAVIT OF STEPHEN P. BEDELL

STEPHEN P. BEDELL, being first duly sworn on oath, deposes and says as follows:

1. I am counsel of record for First Options of Chicago, Inc. ("First Options") in the above-captioned action. I was similarly counsel of record for First Options throughout the entire course of the arbitration proceeding underlying this action.

2. On June 21, 1989, First Options filed a Statement of Claim against MK Investments, Inc., Manuel Kaplan and Carol Kaplan with the Philadelphia Stock Exchange (the "Exchange"). On July 24, 1989, Manuel Kaplan and Carol Kaplan submitted written objections to the jurisdiction of the Exchange.

3. At a pre-hearing conference before the Exchange's Arbitration Committee on February 26, 1990, I suggested that the jurisdictional objections of Mr. and Mrs. Kaplan should be resolved before the Arbitration Committee addressed the other issues to be presented at that conference. At that time, Thomas Zielinsky, then-counsel for Mr. and Mrs. Kaplan (and MK Investments), expressly withdrew the Kaplans' pending jurisdictional objections.

4. On or about December 20, 1991, I spoke by telephone with Lydia Gavalis, the Director of Arbitration at the Exchange. Ms. Gavalis indicated that Michael Waber had been removed from the arbitration panel assigned to this matter, but that Mr. Waber had participated in the February 26, 1990 decision of the Arbitration Committee. I indicated to Ms. Gavalis that such participation by Mr. Waber was improper and that, upon formation of a final arbitration panel, I intended to object on behalf of Fist Options to the Arbitration Committee's February 26, 1990 decision based, in part, on the participation of Mr. Waber therein. Ms. Gavalis indicated that the panel would be reviewing the matter and would consider vacating the award sua sponte to avoid the appearance of bias, if warranted. By letter dated December 20, 1990 to Ms. Gavalis, a copy of which was sent to Donald Perelman, counsel for MK Investments, Inc., Manual Kaplan and Carol Kaplan, I

confirmed this conversation. A copy of this letter is attached as Exhibit "A."

5. The final arbitration panel was constituted in December 1991, and on January 10, 1992, the panel vacated the February 26, 1990 discovery order.

FURTHER AFFIANT SAYETH NOT.

IN WITNESS WHEREOF, I have set my hand this 6th day of August, 1992.

_____
STEPHEN P. BEDELL

[Notarized]

AFFIDAVIT OF DONALD L. PERELMAN

Donald L. Perelman, being duly sworn, deposes and says as follows:

1. I am counsel to Manuel Kaplan, Carol Kaplan and M.K. Investments, Inc.

2. In speaking with Lydia Gavalis, PHLX Director of Arbitration, after the Panel denied the Kaplans' motion to dismiss for lack of jurisdiction, I expressed my surprise at that decision. Ms. Gavalis responded by explaining how the Exchange had purportedly interpreted its jurisdiction rules in the past. She made absolutely no mention of any purported withdrawal or waiver of the objection.

3. Ms. Gavalis gave me the distinct understanding that the motion was denied on the merits.

4. Seymour Specter was not "duped" into accepting service of a subpoena. I spoke with Mr. Specter several times prior to my meeting with him, and explained quite clearly Mr. Kaplan's case and our need for an expert witness. He expressed enthusiasm for Mr. Kaplan's position, and expressed serious disapproval of First Options' conduct. Mr. Specter expressly stated that he would be happy to testify for the Kaplans, but that he was reluctant to do so voluntarily. He therefore agreed with me that he would accept service of a subpoena, and agreed to meet me at MKI's accountant's office for that purpose.

5. At the time we determined to use Mr. Specter as a witness, and at the time we included him on our witness list, we had not yet received First Options' witness list and had no idea that First Options also intended to use a Bear Stearns employee as a witness.

6. At or about the time that Bear Stearns filed its motion to quash the subpoena, Mr. Specter called me from a pay phone to inform me that Mr. Tallento and Bear Stearns counsel had confronted him and, with First Options' counsel on the speaker-

phone, expressed serious reservations about him testifying, and implied that his job might be in jeopardy. Mr. Specter informed me that, to save his job, he fibbed, and told Mr. Tallento et al. that he had been "duped" into meeting with me. I told Mr. Specter that I understood his situation, and that we accordingly would withdraw the subpoena.

7. I subsequently called Bear Stearns counsel. He informed me that First Options' counsel had called him to express concern about Mr. Specter testifying, and that, with First Options' counsel still on the line, he (Bear Stearns counsel) spoke with Mr. Tallento about the situation. He also informed me that, with First Options' counsel still on the line, they confronted Mr. Specter to discuss the situation, and that Mr. Specter informed him that he had been "duped" into meeting with me.

_____
Donald Perelman

[Notarized]

STIPULATION OF FACTS

Solely for purposes of resolving Petitioners' Motion to Vacate and Respondent's Cross-Motion to Confirm, and not for any other purpose, and without any agreement regarding materiality, the parties hereby stipulate to the following facts. The parties further agree that no testimony is necessary to resolve the disputed issues of fact presented by the parties and that this matter can be resolved solely on the basis of the papers presented to the Court to date.

1. On June 21, 1989, First Options of Chicago, Inc. ("First Options") filed a Statement of Claim with the Philadelphia Stock Exchange ("Exchange") against MK Investments, Inc. ("MKI"), Manuel Kaplan and Carol Kaplan alleging the following causes of action:

a. breach of contract against MKI for $6,292,421.60;

b. breach of contract against Mr. and Mrs. Kaplan for approximately $300,000;

c. controlling person liability against Mr. Kaplan for $6,292,421.60;

d. alter-ego liability against Mr. Kaplan for $6,292,421.60; and

e. interests, costs and attorneys fees against MKI, Mr. Kaplan and Mrs. Kaplan. (R. 1-10)

2. First Options filed a Submission Agreement signed by First Options and MKI. Manuel Kaplan and Carol Kaplan never signed any submission agreement.

3. On July 24, 1989, Manuel Kaplan, Carol Kaplan and M.K. Investments, Inc. filed their respective Responses, denying liability. MKI and Mr. Kaplan filed counterclaims against First Options, each seeking $10,000,000 from First Options for breach of contract, interference with prospective business opportunity and libel and slander. (R. 75-79, 99-102, 117-121, 124-128)

4. On July 24, 1989, Manuel Kaplan and Carol Kaplan submitted to the arbitrators written objections to the jurisdiction of

the Philadelphia Stock Exchange. (R. 111, 114) These objections asserted that "The Philadelphia Stock Exchange . . . and the Arbitration Committee . . . lack jurisdiction over this matter and the purported claim should be dismissed." (R. 111, 114.)

5. The Kaplans' then-counsel Thomas Zielinsky withdrew the Kaplans' jurisdiction objections from consideration at the February 26, 1990 discovery conference. The Kaplans thereafter participated without objection in the pre-hearing conference on February 26, 1990.

6. The February 26, 1990 discovery order made no mention of the jurisdictional issue.

7. Neither the Kaplans nor First Options submitted any contemporaneous papers to the Exchange confirming the withdrawal of the Kaplans' jurisdictional objections.

8. Correspondence was exchanged between counsel for the parties and the Exchange between February, 1990 and December, 1991. No discovery proceeded in this matter between February, 1990 and December, 1991, on outstanding discovery requests or otherwise.

9. The Kaplans' current counsel formally replaced former counsel in November, 1991, and received the file in this case in December, 1991.

10. The Panel issued no rulings and conducted no proceedings between February 26, 1990 and January 10, 1992.

11. On January 6, 1992, the Kaplans filed a motion and supporting memorandum seeking the dismissal of the claims against them for lack of jurisdiction. (R. 133) Therein, the Kaplans asserted that no ruling had been issued on the objections they had filed two years earlier and that they were "reiterat[ing] and renew[ing] their objections to the Committee's jurisdiction." (Id.) This memorandum did not state that the earlier jurisdictional objections had been withdrawn. (Id.)

12. The arbitration panel denied the Kaplans' motion to dismiss on January 14, 1992.

13. The Kaplans never sought relief from the courts to enjoin the arbitration.

14. The Kaplans' counsel called Lydia Gavalis after the Panel's denial of the motion. Ms. Gavalis told him that the Exchange had always interpreted its jurisdiction rules in the past to include people like Mr. Kaplan. Ms. Gavalis did not mention to the Kaplans' counsel any withdrawal or waiver of the objection.

15. Lydia Gavalis is the Exchange Director of Arbitration.

a. Ms. Gavalis participated in all Panel hearings.

b. Ms. Gavalis provided counsel to the Panel on many procedural and evidentiary rulings.

c. Ms. Gavalis was the contact-person for counsel with respect to all procedural inquiries.

d. Ms. Gavalis reports directly to William Uchimoto, Exchange General Counsel, who consulted with her on certain decisions in this case.

16. First Options is and has been at all relevant times a member of the Exchange.

17. MKI was a member corporation of the Exchange at all relevant times and has never contested the Exchange's jurisdiction to enter the underlying award against it.

18. From November 8, 1981 to December 8, 1987, Mr. Kaplan personally was a member of the Exchange. (R. 221, T-47) He has not personally been a member of the Exchange since then.

19. As of October 19, 1987 and thereafter, Manuel Kaplan was the sole shareholder, and an officer and director of MKI.

20. Prior to and at the time of the hearing, Mr. Kaplan was a limited partner in G&K Partners, Ltd., which was and is a member firm at the Exchange.

21. In connection with the March 24, 1988 Work-Out-Agreement, several documents were executed by First Options,

MKI, the Kaplans and others. These documents include the following:

Agreement	Parties
(1) Letter Agreement (R. 13-28)	First Options of Chicago, Inc. MK Investments, Inc. Duck Brothers, Inc. Options Investors, Inc. Manuel Kaplan Carol Kaplan Larry Goldberg Ed Manfield Isabelle Benton
(2) Guaranty (R. 29-33)	MK Investments, Inc.
(3) Subordinated Loan Agreement (R. 44-49)	First Options of Chicago, Inc. MK Investments, Inc. Duck Brothers, Inc.
(4) Surbordinated Promissory Note (R. 50)	MK Investments, Inc.

These documents all were executed on or about March 24, 1988. (R. 13-50; T-59)

Vacatur of February 26, 1990 Discovery Order

22. The February 26, 1990 discovery order was entered by a quorum of the Exchange's Arbitration Committee (not by the subsequently appointed arbitration panel). The Order did not identify the individual committee members participating in the decision.

23. One of the members of the Committee who participated in the February 26, 1990 conference was Michael Waber.

24. Mr. Waber's company, Waber Options, participated with MKI in a joint trading venture known as DKW Trading (R. 649),

and Mr. Waber was and is a personal friend of Mr. Kaplan (R. 669).

25. First Options was aware of Waber's joint venture with MKI since the mid 1980s.

26. First Options was aware that Michael Waber was a member of the Arbitration Committee, prior to February 26, 1990, and the membership of the Committee was publicly available at the Exchange.

27. At the outset of the discovery conference on January 20, 1992 and at the outset of the hearing on the merits on May 7, 1992, each arbitrator identified himself or herself.

28. The February 26, 1990 discovery order, inter alia, denied First Options' request for discovery of documents which were prepared before March 24, 1988.

29. In December 1991, First Options' counsel spoke with Ms. Gavalis, the Director of Arbitration, and challenged the validity of the decision based on the participation of Michael Waber. Bedell Affidavit ¶ 4; Gavalis Affidavit ¶ 6. First Options' counsel confirmed his conversation with Ms. Gavalis by letter to Ms. Gavalis, copied to Petitioners' counsel. Bedell Affidavit ¶ 4.

30. After the seven-person arbitration panel was constituted in January 1992 to arbitrate the dispute between the parties, the panel on January 10, 1992, sua sponte vacated the February 26, 1990 decision. Gavalis Affidavit ¶ 6.

Morgan Stanley Proceeding

31. After filing its Statement of Claim, First Options requested the Exchange to produce the taped recording of the arbitration hearing between MKI and Morgan Stanley that had been held on the Exchange.

32. On October 2, 1989, the Kaplans, by their counsel, submitted a letter to the Exchange objecting to First Options' request, and requesting the Exchange to preclude Morgan Stanley from providing a copy of the tape to First Options.

33. On October 4, 1989, the Exchange, by letter to First Options copied to the Kaplans' counsel, denied First Options' request.

34. On August 7, 1990, by letter from Morgan Stanley counsel to the Exchange, Morgan Stanley requested a copy of the tape recording of an arbitration between MKI and Morgan Stanley, for the purpose of providing that tape to First Options for possible use in its arbitration against the Kaplans. The letter was not cc:ed to the Kaplans or their counsel.

35. Subsequent to August 7, 1990, the Exchange gave Morgan Stanley's counsel a copy of the tape recording of an arbitration between MKI and Morgan Stanley, which Morgan Stanley's counsel then gave to First Options' counsel. The Kaplans were not informed of either transfer of the tape.

36. At the hearing of the present dispute, First Options used in the cross examination of Mr. Kaplan an excerpt from Mr. Kaplan's testimony in the Morgan Stanley proceeding.

Denial of the Parties' Contention Interrogatories

37. On December 14, 1991, Petitioners filed their Second Set of Interrogatories, which sought the facts or bases for the piercing the corporate veil claims. (R. 158) First Options objected to these interrogatories as "contention interrogatories" which First Options contended are inappropriate in arbitrations. The arbitrators sustained First Options' objections in this regard. Thereafter, First Options filed its Second Request for Information, attached as Exhibit A, which sought information relating to MKI's and Mr. Kaplan's counterclaims. All five interrogatories contained in First Options' Second Request for Information—which Petitioners characterized as contention interrogatories—were stricken by the panel on the same basis.

Kevin McCarthy

38. In a telephone conversation between counsel approximately twelve days prior to the hearing on the merits, the Petitioners' counsel suggested that the parties identify their respective witnesses with an address, phone number, employer

and/or title, as well as a name. First Options' counsel stated that such information is not required by the PHLX Rules. First Options' counsel told the Kaplans' counsel that if he disagreed with this interpretation, he could contact Ms. Gavalis. Petitioners' counsel did not contact Ms. Gavalis in this regard.

39. The best recollection of the Kaplans' counsel is that First Options' counsel also stated that the Kaplans would recognize all of First Options witnesses, and that there would be no surprises. The best recollection of First Options' counsel is that he stated only that there would be no surprises. The parties agree that testimony will not further illuminate this issue.

40. On January 3, 1992, First Options issued a subpoena to Kevin McCarthy, branch manager of Wagner Stott, a clearing firm at the PHLX.

41. One of First Options' identified witnesses was Kevin McCarthy. In identifying Mr. McCarthy, First Options did not state that he was an accountant. No previous correspondence or conversation between the parties referred to Kevin McCarthy, the accountant.

42. At the hearing, First Options presented as a witness Kevin McCarthy, an accountant from Chicago.

Accounting Exhibits

43. First Options introduced into evidence, over objection, nine typewritten documents relating to Mr. McCarthy's testimony that had not previously been produced in discovery or exchanged prior to the hearing.

44. First Options' counsel called Ms. Gavalis prior to the hearing to confirm their understanding that summaries, compilations and analyses did not need to be produced prior to the hearing and she said that they did not. The Kaplans' counsel were not party to this conversation, and were unaware of it until it was discussed at the hearing, during Mr. McCarthy's testimony.

45. Thereafter, Petitioners submitted summaries of their accounting expert's testimony. (Supp. R. 189) None of these documents were disclosed prior to the hearing.

46. Petitioners produced certain bank statements, checks and financial records on May 6, 1992. The arbitrators denied First Options' objections to the timing of this disclosure. (T-9)

Complaint Regarding Closing Arguments

47. The Panel denied the Kaplans' request for rebuttal of First Options' closing argument, at the hearing.

48. On June 2, 1992, the Kaplans filed a Motion for Reconsideration of Denial of Rebuttal and Motion to Strike.

49. First Options submitted no response to the Kaplans' Motion for Reconsideration of Denial of Rebuttal and Motion to Strike.

50. On June 4, 1992, the Panel denied the Kaplans' Motion for Reconsideration of Denial of Rebuttal and Motion to Strike.

51. The Kaplans requested two hours for closing argument.

52. The Panel initially granted twenty minutes to each side for closing argument. After an executive session, the Panel granted forty minutes to each side for closing argument.

Telephonic Testimony

53. First Options requested permission to present the testimony of Mr. Noble, Mr. Windus, Ms. Lingle and Mr. Moran (residents of Chicago and Singapore) by telephone ten days prior to the hearing, and Petitioners opposed this request. Gavalis Affidavit, Ex. "F" and "G". Petitioners did not make any request to present any of their witnesses by telephone. The panel issued a decision dated April 30, 1992 allowing "any witness" of any party to testify by telephone. Gavalis Affidavit, Ex. "H". At the hearing, First Options presented Mr. Noble, Mr. Windus and Ms. Lingle by telephone. Petitioners cross-examined these witnesses at the hearing, with the exception of Mr. Windus on rebuttal, who was questioned only by the Panel on rebuttal. (T-148-57, 276-90,

346-371) None of the three witnesses who testified by telephone were employed by First Options at the time of the hearing. (T-144, 269, 346)

Transcription of Testimony

54. First Options' counsel asked Ms. Gavalis to transcribe one day of Mr. Kaplan's testimony.

55. On May 20, 1992, Ms. Gavalis sent the parties a letter enclosing the requested transcript, and stating the following:

> Enclosed please find one copy of the transcript of Manny's adverse testimony. You may review the same and make any appropriate changes thereto. Once the final changes have been implemented one copy of the same will be provided to the arbitrators. The transcription was made at the request of the Claimant. No future transcriptions will be made by the PHLX due to the burden related thereto.

56. The Kaplans were unaware of First Options' request prior to receipt of Ms. Gavalis' letter.

57. Upon receipt of Ms. Gavalis' letter, the Kaplans' counsel telephoned Ms. Gavalis to inquire about the letter's message, and Ms. Gavalis informed the Kaplans' counsel that First Options' counsel had requested the transcript, that the PHLX had never provided such a service before, and, because of its difficulty, will not do so again.

58. Petitioners' counsel never objected to the Exchange having transcribed Mr. Kaplan's adverse examination or to any decision by the Exchange to refrain from transcribing additional testimony. Petitioners never asked the Exchange to transcribe any testimony.

Insensitivity to Religious Practice

59. The Exchange scheduled Saturday hearing dates for the sessions set in November 1991, January 1992, February 1992 and April 1992.

60. With respect to the April, 1992 scheduled hearing, the Kaplans' counsel informed Lydia Gavalis that Mr. Kaplan regularly attended synagogue on Saturdays, and requested that no Saturday hearings be held, or that any Saturday sessions be held in the afternoon. Ms. Gavalis informed Petitioners' counsel that the request was denied. The best recollection of Petitioners' counsel is that Ms. Gavalis stated that "Manny will just have to skip synagogue that day." The best recollection of Ms. Gavalis is that she did not state "Manny will just have to skip synagogue that day." The parties agree that testimony will not further illuminate the issue. Ms. Gavalis informed the Kaplans' counsel that Mr. Kaplan could choose to appear in person or by counsel at any Saturday session.

61. The entire hearing subsequently was rescheduled to commence in May 1992 and no Saturday hearings were ever held. (Gavalis Affidavit ¶ 9)

62. After the hearing was set for the May, 1992 dates, the Kaplans' counsel telephoned Ms. Gavalis and requested that any Friday sessions conclude by 7:30 P.M., so that Mr. Kaplan could attend synagogue. Ms. Gavalis informed Petitioners' counsel that the request was denied.

Testimony of Mr. Mullen

63. During the deposition of Timothy Mullen, an officer of First Options, First Options' counsel instructed Mr. Mullen not to answer on relevance grounds, numerous questions regarding the 1987 debit and First Options' trading strategies and trading approach to the MKI account after First Options took over the account in 1987. First Options' counsel argued that MKI and Manuel Kaplan had acknowledged the amount of the 1987 Debit in the Work-Out agreement and never raised any issue about validity of the 1987 debit in their pleadings or otherwise in the arbitration prior to Mr. Mullen's deposition. In its Response to the Statement of Claim, filed on July 24, 1989, MKI denied that it was responsible for the full debt, and stated:

> 1. The MKI trading account incurred a debit balance in the principal amount of $5,176,953.00, but the

incursion of the debit was not attributable entirely to the trading activities of MKI.

2. As of March 24, 1988, as a result of entering into the Agreement, MKI became indebted to First Options in the aggregate amount of $6,227,188.

64. Following Mr. Mullen's deposition, First Options moved to preclude Petitioners from contesting at the hearing the validity of the 1987 debit and for a protective order. (Suppl. R. 193.) The panel ruled that evidence regarding the amount of the 1987 debit would be admissible at the hearing. Petitioners did not file a motion to compel testimony by Mr. Mullen on this point. Petitioners did not file a motion in limine prior to the hearing.

65. The Panel allowed First Options to introduce testimony from Mr. Mullen regarding First Options' trading strategies and trading approach to the MKI account after First Options took over the account in 1987.

The Award

66. On June 5, 1992, the PHLX issued an Award, as follows:

a. MKI and Mr. Kaplan are jointly liable for $5,662,188, plus interest from January 17, 1989 to the date of satisfaction of the Award;

b. Mr. Kaplan and Mrs. Kaplan are jointly liable for $346,342, plus interest from January 17, 1989 to the date of satisfaction of the Award; and

c. The counterclaims of Mr. Kaplan and MKI are denied.

67. The Panel held one deliberating session prior to issuing the Award.

68. Ms. Gavalis informed Petitioners' counsel that the Panel's vote was 5 in favor and 2 against the Award.

69. Ms. Gavalis informed Petitioners' counsel that the Panel's vote was 5 in favor and 2 against the Award.

70. The June 5, 1992 Award is signed by Patricia Bird, Chairperson. It is not signed by any other member of the Panel.

The Parties

71. Carol Kaplan never has been a member of the Philadelphia Stock Exchange.

72. Manuel Kaplan has not conducted any business on behalf of MKI at the Exchange since January 17, 1989.

73. Manuel Kaplan has not actively engaged in the options business on behalf of MKI since January 17, 1989.

74. MKI has not conducted any business at the Exchange since June, 1989.

75. First Options is the largest options clearing firm at the Exchange.

Other Issues

76. No testimony is necessary to resolve these cross-motions. The Court can make all necessary findings based on the papers submitted by the parties, to date.

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Date: September 2, 1992

SUPPLEMENTAL STIPULATED FINDINGS OF FACT

Solely for purposes of resolving Petitioners' Motion to Vacate and Respondent's Cross-Motion to Confirm, and not for any other purpose, and without any agreement regarding materiality, the parties hereby stipulate to the following facts. The parties further agree that no testimony is necessary to resolve the dispute issues of fact presented by the parties and that this matter can be resolved solely on the basis of the papers presented to the Court to date.

1. At the beginning of the hearing, the parties' counsel presented argument to the arbitration panel regarding the propriety of the Petitioners' subpoena issued to Seymour Specter. (Tr. 3-6.) Immediately after these arguments, the panel and Petitioners' counsel had the following exchange:

> PANEL: Are you now withdrawing [Mr. Specter] as witness?
>
> PERELMAN: I think I have to, but I would like the panel to keep in mind that with First Options having started the process, I'm now in a position where a couple of days before the hearing I lose my expert witness . . . .
>
> PANEL: [All right, you are, at this time, withdrawing him?]
>
> PERELMAN: I think we have to. (Tr. 6.)

2. First Options called Scott Talento of Bear, Stearns & Co. as a expert witness. (Tr. 291.) During cross-examination of Mr. Talento, Petitioners sought information regarding Seymour Specter, an employee of Bear, Stearns & Co. Following an objection by First Options to the relevancy of this line of questioning, the panel held an executive session and they sustained the objection. (P. 302-303.)

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IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

- - -

MICHAEL KAPLAN, et al.,	:	CIVIL ACTION
	:	NO. 92-MC-0210
Petitioners	:	
	:	Philadelphia Pennsylvania
v.	:	September 2, 1992
	:	
FIRST OPTIONS OF CHICAGO,	:	
Respondent	:	
	:	
. . . . .	:	

HEARING
BEFORE THE HONORABLE JAY C. WALDMAN
UNITED STATES DISTRICT JUDGE

- - -

APPEARANCES:

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- - -

(Whereupon the following occurred in open court at 3:20 o'clock p.m.:)

THE COURT: Please be seated. We are here in the case of Kaplan and MK Investments, Incorporated, versus First Options of Chicago, Incorporated at Miscellaneous Action No. 92-0210.

The Court has before it cross petitions of the parties, one from the—from MK and the Kaplans to vacate an arbitration award and one from First Options to enforce and reduce to judgment such award.

Also the Court has before it various matters submitted by the parties including portions of the record, an affidavit and so forth, and also proposed findings of fact and I'm not sure if I ever received proposed conclusions of law. If I did, I don't seem to have it here.

MR. McDERMOTT: Your Honor, if I may, you did not receive proposed conclusions of law. I was not under the impression that we were—had been asked to prepare them at this point and Mr. Feder had prepared some. I did not have mine ready so we didn't submit them.

THE COURT: Well, I wouldn't have asked for proposed conclusions of fact and not proposed conclusions of law.

But in any event, most—well, I guess it's fair to say that virtually all of the facts appear to be stipulated to, although the parties obviously don't necessarily draw the same conclusions from those facts and they don't necessarily place the same interpretation on those facts, but perhaps most to the point, the parties do appear to stipulate that no evidence or testimony need be or will be presented on these cross motions beyond the record already adduced. And presumably thereby the parties are agreeing that the Court has in front of it anything that either party thinks is at all material, relevant or pertinent to decide the issues in the case.

Is that right?

MR. FEDER: Yes, sir.

MR. McDERMOTT: Yes, sir.

THE COURT: Well, if that's so, then—now, there was an affidavit of Ms. Gavalis, but again no one is—apparently you've agreed that what she would testify to if she has been called to testify in person subject to cross-examination is in fact what she said in her affidavit, I take it.

MR. FEDER: For the most part, yes, your Honor.

THE COURT: Well, I don't want there to be the slightest doubt or confusion on the record. There is no fact that in any way is relevant, material or pertinent that you disagree on or that cannot be ascertained according to all parties by reference to the matters already of record.

Is that what you're —

MR. FEDER: Your Honor, if I could clarify, there are two facts which are not of major significance but they are arguably material where there clearly is a disputed recollection between the parties. Neither party chooses to question the good faith of each other's recollection and we have submitted to the Court conflicting recollections, but ask, but submit to the Court that there's no purpose to be served by cross-examination of the other party's recollection of particular facts.

My guess is the Court will find that it's not going to need to resolve the dispute regardless the parties have agreed to stipulate.

THE COURT: Well, I'm not sure what you're referring to, but if it's material and you can't agree on what happened, how am I supposed to determine what happened if we don't have any evidence or testimony?

MR. FEDER: I think it will become clearer in argument. It's hard to answer that in the abstract, other than it may not be material.

THE COURT: Well—

MR. McDERMOTT: If I could, your Honor, put the comments in, just put the comments in context that the two points that apply in this situation are, one, whether or not when counsel

for petitioners were speaking with Ms. Gavalis on the phone regarding a rescheduling matter, she said, quote "Manny will just have to skip synagogue that day."

Counsel for petitioner recalls her saying that, Ms. Gavalis does not—recalls not saying those words. Our position, First Option's position is that's not a material fact which need —

THE COURT: Well, this goes to one of the 14 allegations of bias?

MR. FEDER: Yes, sir.

THE COURT: That they wouldn't let one of the parties take off for a religious observance or something, is that it? Well, why wouldn't that conceivably be material?

MR. FEDER: Because, your Honor, it's agreed as to the substance of the conversation that she would not let the party take off for a religious observance. The exact language that she used we are willing to —

THE COURT: Oh. Well, let me understand this because it's uncontested that the party asked for a continuance for the purpose of attending a religious observance. I take it that—is that uncontested?

MR. McDERMOTT: Yes.

THE COURT: And she said no?

MR. McDERMOTT: Correct, yes, correct.

THE COURT: What's contested is whether she also made some gratuitous statement about whatever it is you just said.

MR. McDERMOTT: Correct.

THE COURT: "You will just have to miss your holiday" or words to that effect?

MR. McDERMOTT: Correct.

THE COURT: Okay. All right. Well, let me again, because I want there to be no doubt of the question, putting that

one minor little thing aside, I want to make sure I understand this, there is no material fact to which either you have not stipulated or as to which you have not agreed the Court could ascertain it by reviewing the materials already submitted, is that correct?

MR. McDERMOTT: Your Honor, that is essentially correct. I do have with me today a set of First Options' exhibits which were the bulk of our paper case in chief at the arbitration.

In going through the transcript there are references to, during the witness' testimony, to Exhibit A, Exhibit B, et cetera. Some of these things were provided in the supplemental record, not all of them were provided —

THE COURT: You can't have it all ways. Now, if you have evidence or testimony to present, present it. I mean, I'm relying on your written stipulation, but apparently it's not altogether accurate. Put in front of me right now any testimony or evidence you have. I don't know what else to say.

MR. McDERMOTT: Your Honor, I guess then I'd just like to provide the Court with these documents, if I may.

THE COURT: Well, I don't know what they are. If your adversary stipulates to what they are and to their authenticity, then maybe you'll be able to get them in evidence without having to call a witness, I don't know.

MR. McDERMOTT: I did discuss with Mr. Feder that I would have these with me today and would offer them up, if it seemed appropriate. These are the exhibits that—copies of exhibits provided at the arbitration.

MR. FEDER: Your Honor, assuming those are the actual exhibits that were introduced at the hearing, we have no objection to their introduction.

THE COURT: The—this is a copy—

MR. McDERMOTT: Yes.

THE COURT: —of exhibits that were submitted to the seven arbitrators, is that what these are?

MR. McDERMOTT: Correct.

THE COURT: And that have not heretofore been submitted to the Court.

MR. McDERMOTT: Right.

THE COURT: And you agree that's what they are? No question as to their identity or authenticity?

MR. FEDER: I have not seen—I—why don't you give me a second to look through them.

(Pause.)

MR. FEDER: Your Honor, these appear to be—these certainly appear to be the documents that are presented to the arbitrators. I don't recall whether every one was admitted into the evidence. I have no objection to their entry into the record here.

THE COURT: Well, I need to have them not only identified and authenticated, I need to understand what they are. I mean, these are exhibits which you agree were actually submitted to the seven arbitrators. Is that what you're about to introduce here?

MR. McDERMOTT: Yes.

MR. FEDER: Yes, sir, by First Options.

MR. McDERMOTT: And the only—and the reason I'm providing them to the Court is because you have already been provided a transcript of the witness' testimony. I think it will assist you in—when referring to the transcript, to have the exhibits available.

THE COURT: I just want to make sure there's no contest as to what they are. These are the exhibits or at least accurate reproductions of the exhibits that were submitted to the seven arbitrators, is that correct?

MR. McDERMOTT: Yes.

MR. FEDER: Yes, sir.

THE COURT: And you are moving them into admission. Do you have any objection?

MR. FEDER: No, sir.

THE COURT: All right, we'll admit them.

MR. McDERMOTT: Thank you.

THE COURT: My question recurs, do you now agree that there is no material fact in this case either to which you have not stipulated or as to which the Court cannot make an adequate factual finding by reviewing matters that have been submitted and made part of the record, without taking further testimony or evidence?

MR. McDERMOTT: Yes.

MR. FEDER: I agree.

THE COURT: All right, if that's the case then we'll, I assume there's nothing more to do except afford you some time to argue, if you wish to do that.

MR. FEDER: We do, your Honor.

THE COURT: All right, well, I'll hear you.

MR. FEDER: Does the Court have a preference as to whether I stand here or at the podium?

THE COURT: No preference whatsoever; whatever makes you happy.

MR. FEDER: Thank you.

May it please the Court, I am Richard Feder. I represent petitioners Manuel Kaplan, Carol Kaplan and MK Investments, Inc.

It's pretty clear to me from the previous conference we had with the Court that your Honor is already fairly familiar with the issues, read the briefs. I will try to highlight what I think are the important points. I can't possibly cover the whole argument, the whole case, and I'm sure your Honor doesn't want me to.

THE COURT: We'll cover anything you think is important, but every now and then we get some free time so we do read the filings and the various briefs that are submitted.

MR. FEDER: And we lawyers try to keep that, your free time, to a minimum, I'm sure you feel.

Your Honor, Manny Kaplan was an options trader on the Philadelphia Stock Exchange from 1981 to 1989. In 1984 his partnership incorporated as —

THE COURT: Well, assume I'm familiar with the facts and why don't you focus your argument on the points that are in contention?

MR. FEDER: Certainly, your Honor.

THE COURT: That the arbitrators exceeded their authority, that they displayed bias—well, I guess the term is actually impartiality—and all of that kind of thing.

MR. FEDER: I will assume you're familiar with the facts.

Your Honor, First Options brought this case before the Philadelphia Stock Exchange Arbitration Panel seeking to pierce the corporate veil, seeking to impose contractual liability, impose personal liability on Mr. Kaplan for a debt that First Options contracted with the corporation.

Mr. Kaplan and Mrs. Kaplan, they also sued Mrs. Kaplan to pay over a tax refund which they had agreed to pay in —

THE COURT: Well, this was a joint tax refund for about $300,000 correct?

MR. FEDER: That's correct.

THE COURT: And therefore—I'm no expert on tax law, but if they filed a joint return and got a joint refund, they would own that jointly and severally, wouldn't they?

MR. FEDER: I would think so. I'm no expert on tax law, but regardless, the parties, Mrs. Kaplan signed that agreement.

THE COURT: This is how she got in the case, by signing the agreement, right?

MR. FEDER: Correct.

What Mrs. Kaplan did not sign and what Mr. Kaplan did not sign was any agreement to bring this dispute to arbitration, to bring any dispute with First Options.

THE COURT: Well, MK was a member of the Exchange and, as such, why was it not bound by the agreement that all members of the Exchange would arbitrate any disputes or grievances related to the securities business of either? And since the Exchange defines "member" to include any principal who is involved with a member?

MR. FEDER: I guess it's that last since that that we disagree with. I would argue quite strongly that you never even need to get to the rules because the parties had a specific contract divvying up what's going to go to arbitration, who's going to go to arbitration and who's not.

THE COURT: You're talking about the workout agreement?

MR. FEDER: Yes, sir. But I'll —

THE COURT: But can't we look for the source of an agreement to arbitrate in more than one place?

MR. FEDER: Certainly we can, but I think there's a general principle that says when parties specifically contract with respect to a particular issue, the fact that there are general rules out there don't apply when the parties clearly have the right to contract around those general rules and, your Honor, that is what happened here.

THE COURT: So you want me to read the arbitration provision in the so-called workout agreement as a subsequent agreement to limit the scope and applicability of the general arbitration agreement, is that what you're saying?

MR. FEDER: Without conceding for a moment that the general arbitration rules would apply here, yes, sir, that is exactly correct. I don't think you need to look to whether the general rules apply because the arbitration agreement had, the workout agreement—excuse me—had four separate documents, only one of which contained an arbitration provision and that one document was only signed by MK Investments, Inc. It was not signed by Manny Kaplan, it was not signed by Carol Kaplan. The parties clear intent was to—this workout agreement, as you know, was negotiated over four and a half months, both sides had very competent lawyers.

THE COURT: Well, I assume that always.

MR. FEDER: I probably went outside the record in stipulating that their—their lawyers were competent, but —

MR. McDERMOTT: I'd offer to stipulate to that.

MR. FEDER: The clear intent of the parties as expressed in this 28-page series of documents was that MK Investments would be subject to arbitration, Manny Kaplan and Carol Kaplan would not. If First Options wanted to subject Manny and Carol Kaplan to arbitration, it wouldn't have been very difficult to ask them to sign that provision or to put that provision in one of the documents that they did sign. They didn't ask them to do that. I can't imagine a clearer expression of the parties intent.

Having said that, your Honor, you asked me about the rules themselves. I do not agree with the Court's characterization that a —

THE COURT: Well, I'm just asking questions.

MR. FEDER: All right.

THE COURT: I wouldn't be presumptuous enough at this stage to characterize anything.

MR. FEDER: I would respectfully characterize the rules as not by any stretch stating that an employee or an officer of a member firm is a member. In fact, if you look at the rules carefully, the rules clearly distinguish between members and

associated persons of members, of member firms. And if you get to the rules at all, the rules themselves in Section 1 set up the general we call it the jurisdiction provision of the Exchange, it's entitled "Matters eligible for submission."

And in that provision it says that disputes between members are eligible for submission. It does not say but disputes between members and associated persons are eligible. The rules plainly recognize that there's a difference because it uses the term "associated persons" elsewhere in the rules. So I'd respectfully suggest that the rules, even if you look to them, do not apply here. Mr. Kaplan has not been a member since —

THE COURT: 1987, according to you.

MR. FEDER: 1987.

THE COURT: But isn't there something in there also about former members and people who were members at the time of the relevant conduct that's the subject of the dispute?

MR. FEDER: If I can paraphrase the commentaries that a former—a member who was—let me not paraphrase.

That for purposes of this rule the terms member, member organization and associated persons of a member shall be deemed to encompass those persons who were Exchange members at the time the circumstances occurred which gave rise to the controversy.

Before I address the language, the commentary doesn't apply here anyway because it's not a part of the rules that apply to this controversy, they are a part of an older set of rules which have been amended and even under the old rules, the commentary only applied to disputes between members and customers, not members and members.

But looking at the commentary, since the Court inquired, this dispute did not arise out of circumstances that occurred when Mr. Kaplan was a member. This dispute is over a breach of a workout agreement. The workout agreement was signed in March of '88, the breach allegedly occurred in May of 1989.

There clearly was evidence that was introduced that predated the workout agreement, but I'm sure your Honor recognizes that evidence is always introduced prior to the time the circumstances out of which an act or a cause of action arose, and so Mr. Kaplan's prior membership does not by any means make him a member for purposes of jurisdiction.

I think it's extremely important to remember that, if you do get to the rules at all, they plainly don't apply to Carol Kaplan. Carol Kaplan was never a member of the Exchange, never had anything to do with the Exchange. The parties agreement is the only possible source of jurisdiction.

THE COURT: And was not associated with MK?

MR. FEDER: And was not associated with MK, that's correct, sir. And there's no contention that there's any source of arbitration jurisdiction over Carol Kaplan other than the agreement, but the agreement speaks for itself and Mrs. Kaplan didn't sign the arbitration agreement.

THE COURT: Well, let me ask you a question. Maybe I should wait, but if we hold that there was no jurisdiction as to Mrs. Kaplan, I mean, aren't we just giving you snow in winter? I mean, what does that do for you really? I mean, if the tax refund is jointly both of theirs, you lose the same amount of money one way or the other, don't you?

MR. FEDER: Your Honor, I'm not familiar with the details of my clients' financing situation, but Mrs. Kaplan's money is separate and if Mr. Kaplan can't satisfy the judgment, then under the current order First Options could go after Mrs. Kaplan's money as well.

THE COURT: Well I don't —

MR. FEDER: Mrs. Kaplan is a separate individual.

THE COURT: I don't have the order in front of me, but are you saying they entered judgment—no, they didn't enter any judgment. Are you saying they found that she is liable for the whole $6 million?

MR. FEDER: No, sir, only for $345,000 tax refund.

THE COURT: Well, that's my—that's my recollection and that's my point and that's why I asked the question. In other words, if they had no jurisdiction, then you don't force the award against her for that limited amount of money.

MR. FEDER: Correct.

THE COURT: All right. But they would get it anyway, would they not, if the award were enforced against Mr. Kaplan and they also have an agreement to sue on which he signed? Do they not?

MR. FEDER: Oh, if what you're saying is they ultimately will—will win their lawsuit against Mrs. Kaplan in Common Pleas Court, I by no means concede that.

THE COURT: I don't know if —

MR. FEDER: I—you are correct, what they would have to do then is bring another proceeding against Mrs. Kaplan if they don't collect the full extent of the judgment from Mr. Kaplan, and I don't think your Honor wants to pre-judge the merits of that lawsuit.

THE COURT: Well, I'm just simply asking—well, go ahead, go ahead.

MR. FEDER: Mrs. Kaplan would have some very substantial defenses to that lawsuit. I could pick them off if you wanted, I doubt you're interested.

THE COURT: So your theory is that if Mr. Kaplan cannot satisfy the judgment or cannot satisfy it to within $300,000, then this could become relevant?

MR. FEDER: Then this could become relevant, yes, sir. Your Honor, $6 million is a lot of money.

THE COURT: Well, I guess it is; I've never been in a position to find out.

MR. FEDER: Your Honor, First Options contends in its brief that the Kaplans waived all of these objections to jurisdiction. First Options completely ignores Third Circuit precedent that says a waiver has to be clear, only a party who clearly forgoes his right to judicial review of a jurisdictional issue does waive it. And there is no evidence in the record of a clear and express waiver.

THE COURT: Well, maybe I didn't read all the cases you did. I don't recall anything about express waivers. I do recall reading something about a clear indication. I assume if the Court wanted to say express waiver, they knew how to say that, didn't they?

MR. FEDER: Your Honor, I'll —

THE COURT: Is there a difference between an express waiver and a clear indication?

MR. FEDER: Yes, sir, yes.

THE COURT: For example, may we not find a clear indication from one's conduct?

MR. FEDER: Yes. I think you can find something from conduct, but it's got to be pretty clear. Let me, if I could, just find the exact quote. It was either Pennsylvania Power or International Brotherhood, which we cited in our reply that was not cited in the First Options brief.

THE COURT: I am familiar with the case. I think you will find the words they use are clear indication.

MR. FEDER: A clear indication of an intent to forego judicial review, I think was the phrase.

Your Honor, the only evidence that First Options points to give the Court this clear indication of an intent to forego judicial review is counsel's decision to withdraw his objections from consideration at one preliminary conference. There is no way that that decision constitutes a decision to waive with prejudice. If the parties —

THE COURT: Well, I assume they also point to the fact that they participated in the arbitration and then —

MR. FEDER: Your Honor, I do think Pennsylvania Power and International Brotherhood are crystal clear that the decision to participate in an arbitration, having made an objection to the jurisdiction and having argued both jurisdiction and the merits absolutely does not waive the right to judicial review of that decision and in fact judicial determination of that jurisdictional question.

THE COURT: Well, I don't know, was York Air wrongly decided? Was Judge DuBois wrong and did the Circuit Court just mess up when they affirmed him?

MR. FEDER: I have no idea whey they affirmed him with that opinion. There is indication in there that there may have been a clear intent to waive; I don't have the full record from York Air. It is not clear from the opinion, but I do cite a couple of lines which give that indication.

THE COURT: Well, Judge DuBois found, quote, "York Air vigorously argued from the start that the panel did not have jurisdiction."

MR. FEDER: Your Honor, Judge DuBois relies on two Ninth Circuit cases which are in direct conflict with Pennsylvania Power and International Brotherhood.

THE COURT: And the Third Circuit missed that when they reviewed his opinion?

MR. FEDER: I do not agree with that characterization. The Third Circuit can affirm for any reason totally unrelated to what's—what's presented in that brief—in that opinion. I'm sure the Court has sat on the Court of Appeals, I clerked for the Court of Appeals.

THE COURT: Well, this is the only issue though, I mean, it's a short opinion, this was the only issue.

MR. FEDER: That—that's exactly what you don't know. You do not know why they found it. They may well have looked

to the actual jurisdiction issue and said there was jurisdiction, so we'll affirm with that opinion. They may have said—that would be most likely—I mean, that to me is the most likely decision.

I would respectfully ask the Court to read International Brotherhood and Pennsylvania Power carefully because I think there can be no doubt.

THE COURT: I have read them both, so —

MR. FEDER: Okay.

THE COURT: I have also read the more persuasive line of cases that hold to the contrary, but unfortunately they're from the Second Circuit.

MR. FEDER: Your Honor —

THE COURT: Not to mention the 9th, the 11th and just about every other circuit in the country.

MR. FEDER: I think I cite the First and the Seventh as being on—with the Third Circuit. I don't remember exactly which circuit.

THE COURT: Well, I don't know, I've looked at opinions from the Fourth Circuit, the 11th Circuit, the Second Circuit—well, not surprisingly, most of these opinions are either from the Second Circuit or the Southern District of New York cause that's where a lot of this comes up.

MR. FEDER: The First and the DC Circuit are definitely in agreement with this circuit, but with all respect, I think we're in Philadelphia.

THE COURT: Well, where we are is irrelevant; the question is what law applies. And I'm familiar with the cases, but I also am not 100 percent certain nor will I be till I re-read them a couple more times —

MR. FEDER: I would hope the Court would —

THE COURT: —exactly how—how they might or might not be read against what I consider to be very persuasive argu-

ments from Courts in New York that where one participates in a proceeding and only when an adverse award is entered does one start complaining about arbitrability and one might be somewhat skeptical, but go ahead.

MR. FEDER: All right. Your Honor, if the Court is at all inclined to revisit the Third Circuit precedent, I respectfully suggest that the Third Circuit reasoning makes perfect sense and the logic is that a contrary rule as set up in some of the other circuits but not the First and the DC Circuit.

THE COURT: Well, if you take a look at these opinions—and I don't really want to spend a lot of time on this right now—at least some of them come up in a slightly different context where everybody agrees that they agreed to arbitrate. And the question is did they agree to arbitrate a particular issue or type of issue and arguably different considerations and a different rationale might pertain, but why don't you get on with your argument?

MR. FEDER: Well, I recognize that distinction and I think that if that is the distinction, it only can help us because what we're talking about here is whether Mr. Kaplan ever agreed to allow these arbitrators to decide anything.

THE COURT: Yes, I —

MR. FEDER: Seems to me —

THE COURT: I un—

MR. FEDER: Seems to me those parties had agreed to submit something to arbitration so it wouldn't be so terrible if the arbitrators decided —

THE COURT: No —

MR. FEDER: —what they decide.

THE COURT: No, not at all. It would be a lot more logical for parties who agreed that they agreed to arbitrate a wide variety of issues to proceed and let the arbitrators initially determine whether one of the issues in dispute fell within those bounds without waiving their right later to claim it didn't than it

would be reasonable to expect a party who sincerely believed they had never agreed to arbitrate anything to nevertheless proceed to and through arbitration and then complain only after an adverse award was entered.

MR. FEDER: It's not them complaining only, we clearly presented the argument to the panel. It's not as if we thought of this after we lost.

THE COURT: Well, that's in dispute, but —

MR. FEDER: I—I recognize that.

THE COURT: —let me—let's just hear your argument. Go ahead.

MR. FEDER: With respect to that dispute, your Honor, if the parties who were there at the time felt that there was a clear intent to forego a waiver of the right to pursue a jurisdiction objection, one would think that First Options would have confirmed that fact in a letter, in a memorandum, in something at the time. Lawyers don't usually say: well, you waived it and we'll just trust you.

Likewise, when the panel ultimately denied our motion to dismiss, it's uncontested that Ms. Gavalis informed my co-counsel that—I'll try to get the language as precisely as I can without misstating it—she stated that the Exchange has always interpreted its rules to include people like Mr. Kaplan and she did not say anything about a waiver.

One would have thought that gratuitous comment wouldn't have been made if there really had been a concern about waiver.

Your Honor, jurisdiction is a threshold issue and obviously we don't feel you need to address anything beyond that, if you see it our way, but we have presented —

THE COURT: Well, there's two issues. Was there jurisdiction and if there wasn't, was there a waiver.

MR. FEDER: Yes, sir.

THE COURT: I mean, there's really two issues.

MR. FEDER: It's two threshold issues, I would agree with that.

We presented several other arguments obviously for why this award should be vacated. I'd like to highlight two of them for purposes of this argument.

Number one, this award was in manifest disregard of the parties' agreement and therefore of the law. Manny Kaplan was released unconditionally, unequivocally from personal liability for all acts that he may have performed preceding the workout agreement.

The language of the release is clear, it is unambiguous. The panel ignored it. The law is clear, First Options doesn't agree—doesn't disagree, and if the panel rewrites the parties' agreement, the panel ignores the —

THE COURT: Well, the award has to derive at least tangentially from the essence of the agreement.

MR. FEDER: Yes, sir.

THE COURT: I assume that's your argument.

MR. FEDER: Yes, sir. And where language in a contract, and in this case a release, is clear and unambiguous, the Court is free and in fact is required to revisit that question.

THE COURT: Can rewrite the terms of the agreement for the parties. This is —

MR. FEDER: The Court is required to make sure the panel did not rewrite the terms.

THE COURT: Well, the panel cannot do that, yes.

MR. FEDER: Yes, sir.

THE COURT: I understand.

MR. FEDER: If you compare the release of Mr. Kaplan with the release of the corporation, it's quite clear that the parties who had expressed a conditional release when they wanted to, the corporation's release begins upon termination of this agreement,

Mr. Kaplan's release doesn't say that. Mr. Kaplan's release was in effect upon the signing of the agreement and the panel's decision to ignore it was in disregard of that agreement.

Now, I'm not going to parse the language, the Court's going to, I'm sure, read it and decide for itself, but First Option contends—do I see a question coming?

THE COURT: No, I'm just eagerly awaiting—

MR. FEDER: I apologize.

THE COURT: —to hear what it is that First Options contends.

MR. FEDER: First Options contends that maybe the panel rescinded the release, rescinded the agreement and therefore could have ignored it because the whole workout had been rescinded. But it's quite clear from what happened that the panel enforced the agreement, the panel ordered Mr. and Mrs. Kaplan to pay over the tax refund. There is no source of that obligation other than the agreement itself, that can't be disputed, the panel plainly did enforce the agreement and therefore the panel is obligated to enforce the release.

It is also clear that given —

THE COURT: You're talking about the so-called workout agreement?

MR. FEDER: Yes, sir. Given the fact that Mr. Kaplan was released from liability prior from all—for all acts prior to the workout agreement, the only thing the panel could look to is anything that happened after the workout agreement.

Well, it's clear that after the workout agreement—we contend before, too, but we only need to focus on after—after the workout agreement, Mr. Kaplan and MKI were kept scrupulously separate. The only piece of evidence that First Options can point to that occurred after the signing of that release occurred also after Mr. Kaplan was kicked out of his office, after MK Investments was out of business, after MK Investments had closed out its checking account, Manny—First Options—MK Investments had

several thousand dollars which should have come to MK Investments, instead was directed directly to Mr. Kaplan.

THE COURT: I'm not sure I follow this. You mean in receivables or money that was cash on hand or —

MR. FEDER: Receivables, receivables. It is simply in manifest disregard of the law to conclude that those few thousand dollars alone turn the corporation MK Investments into a sham and allow the piercing of a corporate veil to the extent of a $6 million award.

Your Honor, I would like to talk about bias. The law's clear that the Court can infer bias from the proceedings, from the acts of the arbitrators. You don't need to actually find an arbitrator who gets up and says: Yes, I really didn't like Manny Kaplan.

THE COURT: Pretty strict standard though.

MR. FEDER: It is not something that courts do every day, but it's also clear that the Court has a higher obligation to look into this question because—because of the deference of the arbitrators. The Court does have an obligation to make sure that the arbitration process itself was fair. And if we don't have faith that the arbitration process itself was fair, then the deference —

THE COURT: Well, where's a requirement of fairness? I read the requirement in the act refers to evident partiality. I mean, what if the panel is unfair to everybody, what if they're just a bunch of ignoramuses?

MR. FEDER: I think that would also be grounds for refusal, for vacating, but not on the evident partiality strand, rather on the —

THE COURT: Well, we're on the partiality strand, are we not?

MR. FEDER: Yes, sir. And —

THE COURT: And partiality, at least according to the dictionary, I think, means partial to one side over the other, right?

MR. FEDER: That's correct, that is correct. And we believe that the series of 14 or 15 points that we've presented, when viewed collectively, can only be explained by partiality towards First Options.

THE COURT: But not individually. In other words, there's no one of them that standing alone, in your view, which would cause a reasonable person to be forced to conclude that there was partiality; I have to look at all of them, is that what you're saying?

MR. FEDER: I—I don't say that you have to, I think that makes it a lot easier for you. I think there probably are one or two which might stand out.

THE COURT: What are they?

MR. FEDER: I will certainly try to present what I think are the—are the clearest indications. Number one, the vacatur of the discovery award—discovery order. February of 1990 the arbitration committee held a discovery conference and issues an award—and issues a discovery order that's favorable to the Kaplans. Michael Waber (ph.) participates in that decision. First Options agrees—admits that it knew that Michael Waber was a friend and business associate of Mr. Kaplan at the time and it knew that Michael Waber was a member of the arbitration committee. And it also admits that it didn't object to his participation in that decision.

Two years later the panel sui sponte vacates that discovery order because Mr. Waber participated, even though First Options hadn't objected. First Options now tries to justify that decision solely by contending that they didn't know Mr. Waber actually participated in the particular decision, only that he was on the committee, even though First Options participated in the conference itself at which Mr. Waber participated.

There's nothing in the record to support First Options lack of knowledge and logic says they knew or should have known. The panel's decision to vacate, to vacate the previous award

without any prior objection struck us—and we hope it strikes you—as inexplicable other than evident partiality.

THE COURT: Maybe they thought they made a mistake?

MR. FEDER: It is stipulated by the parties that they, it's a new panel and the vacatur was because Michael Waber was a member of that panel without any review of the merits. They subsequently reviewed the merits and decided the decision against us, you are correct, but the vacation was done on the basis of Mr. Waber's participation.

THE COURT: Well, that I understand.

MR. FEDER: There was no—there was no looking at the merits at that point.

THE COURT: Well, I understand.

MR. FEDER: The fact that they made a mistake ultimately is how we suffered prejudice.

THE COURT: I'm talking about the subsequent decision that you don't like.

MR. FEDER: Oh.

THE COURT: Well, maybe I don't follow your argument. In other words —

MR. FEDER: That just shows we were prejudiced.

THE COURT: In other words, for partiality I should only look to the vacation of the original order. You don't suggest that the subsequent entry of the other order reflects partiality?

MR. FEDER: I don't think there's any evidence that I could present to you to suggest that.

THE COURT: Okay.

MR. FEDER: Number two, the Morgan Stanley tapes. First Options requested a tape recording of an arbitration proceeding, a confidential proceeding between Mr. Kaplan and Morgan Stanley.

Mr. Kaplan's counsel—the Kaplans' counsel objected to this request in writing and asked the Exchange to preclude Morgan Stanley from giving the tapes to First Options. The Exchange agreed with the Kaplans and denied First Options' request. A year later, without notifying the Kaplans, Morgan Stanley by its counsel asked the Exchange for the tapes and expressly says: we'd like to give it to First Options because we think it would be helpful in their case.

The Exchange, knowing that First Options—that the Kaplans have previously objected to this, knowing that the Kaplans are under the impression that their objection has been sustained, the Exchange turns around and gives the tapes to Morgan Stanley for the express purpose of giving it to First Options without telling the Kaplans about the request and without telling the Kaplans that they're giving over the tape.

That to us is inexplicable other than total insensitivity to the Kaplans' concerns and evident partiality.

Your Honor, the panel persistently refused to allow us to cross-examine First Options' witnesses adequately, two quick examples:

Scott Talento, their expert witness. The beginning of the hearing we made a statement on the record explaining our belief that Mr. Talento and First Options together had tampered with our expert witness.

First Options' counsel gave their version of whether that happened, you can look at the affidavit and the record, determine whether that happened, it's not material. What is material is the fact that Mr. Talento is the only witness who could provide any facts on this question. We asked him a couple of questions trying to look into his discussions with Mr. Spector, our expert witness, and the panel wouldn't let us. They weren't interested in the potential bias that this showed, they weren't interested in what this said about First Options' approach to the case. All they were interested in was hearing Scott Talento's direct examination but not our cross.

Number two, Gary Wendice. He reappears on rebuttal, two weeks after he had a chance to say exactly what he could have said two weeks ago, but after the Kaplans had finished their case. The panel decides to ask him questions on their own, but the panel asks precisely the same questions that First Options would have asked and then doesn't give the Kaplans a chance to poke holes in that story.

I can't conceive of any reason why they didn't allow us to cross-examine him at all on what everybody agreed was a pretty critical issue, other than bias.

The final point that I'll make on bias, unless you'd like to inquire of any others, your Honor, is their insensitivity to religious practice. The parties agree on the facts. Counsel for the Kaplans called up Ms. Gavalis, informed her that Mr. Kaplan regularly attends synagogue on Saturdays and requested that no hearing sessions be held on Saturday. And subsequently a similar request that no hearing sessions be held on Friday after 7:30 because he regularly attends synagogue on Friday evenings.

Ms. Gavalis responded the same way both times, after consulting with Exchange counsel: "No, if Mr. Kaplan wants to attend synagogue, his counsel can attend the hearing. He has the choice."

Your Honor, I submit to you that's not a choice.

THE COURT: Well, I'm not sure I follow you here. You're telling me that the insensitivity on the part of certain persons to the exercise of religion would show that they were partial, biased and prejudiced against the party on the merits of the dispute?

MR. FEDER: Yes, your honor, I do believe that what that shows is that there's no consideration for the Kaplans' needs. There's consideration for First Options.

THE COURT: Was there anything of record that would suggest that anyone associated with First Options asked for a continuance so that he or she could attend some religious service and they were treated differently?

MR. FEDER: No, your Honor, there is not.

THE COURT: All right, anything else?

MR. FEDER: Your Honor, I have nothing further, other than I do trust the Court will review our briefs pretty carefully and, if necessary, allow me a few minutes for rebuttal.

Thank you.

THE COURT: All right. Well, if necessary, we'll give you a few minutes to rebut, otherwise we might be accused of evident partiality.

Does First Options want to be heard at all?

MR. McDERMOTT: Your Honor, if I may, a short—I think this will be relatively brief. My name is Tim McDermott. I'm with Gardner, Carton & Douglas and I represent First Options. Here with me today is Walt Einhorn. Steve Bedell who was the -- is the partner on the case and the lead attorney could not be here. He had a previously scheduled hearing and I apologize for that.

I think what the Court needs to focus on in this situation is what our role is here in confirming arbitration award, vacating an arbitration award regarding points of bias or prejudice or evident partiality, the standard whether there was any prejudice to the parties as a result —

THE COURT: Well, let's start at the beginning because I confuse easily.

Isn't the first question you might want to address whether or not there was ever an agreement to arbitrate? Whether the—whether the award was entered in excess of any powers conferred upon the arbitrators, whether they acted with no jurisdiction?

Would that be a good place to begin before we get into what the test for partiality is?

MR. McDERMOTT: Sure. I think that it's clear the parties agree that there was jurisdiction over MK Investments. Regarding Mr. Kaplan, I think it's —

THE COURT: Well, it's my understanding that, based on all your submissions, MK is effectively defunct, is it not?

MR. FEDER: Yes, your Honor.

THE COURT: And I assume MK does not supply a source for recovery for you or you wouldn't be worried about the Kaplans, is that right?

MR. McDERMOTT: That is correct, sir. The dispute regarding Mr. Kaplan and Mrs. Kaplan involves two main points really: one, that Mr. Kaplan was a member of the Exchange, as that term is interpreted and defined under the Exchange rules and also the United States Code.

THE COURT: You lost me on the last curve. Somewhere in the United States Code which contains 50-some volumes I'm going to find a definition of member of the Philadelphia Stock Exchange?

MR. McDERMOTT: There are definitions of what associated persons are. The cites are provided in our brief. I —

THE COURT: You just don't recall the cite?

MR. McDERMOTT: Offhand I do not recall the cite.

THE COURT: All right.

MR. McDERMOTT: The status of Mr. Kaplan as the director, officer and sole shareholder of MKI renders him an associated person and a member of the Exchange. Under the rules of the Exchange as they've been interpreted by the courts, the rules constitute a contract between the Exchange and its members and provide where the rules provide for arbitration, the members are bound to arbitrate.

THE COURT: Well, is it—it's uncontested, isn't it, that he was not a member of the Exchange after sometime in the spring of '87, was it?

MR. McDERMOTT: After I believe December of 1987—

THE COURT: Okay, the fall of '87, all right.

MR. McDERMOTT: He was no longer personally a quote, unquote, "member of the Exchange."

THE COURT: But under your theory he was still a member because of his association with MK?

MR. McDERMOTT: Correct. In addition, before December of 1987 the part of—part of what constitutes the basis of this arbitration award and that is the crash in October of 1987, the deficit incurred in October of 1987, certain conduct which happened at that time, representations, what we contend were misrepresentations made by Mr. Kaplan and his counsel to First Options and the negotiation of the March 24, 1988 workout agreement, all those activities predated the termination of Mr. Kaplan's status as a member of the Exchange in his individual capacity.

In addition, after that date he continued to be a member as interpreted by the rules. Also—and this goes to Mrs. Kaplan as well—in the workout agreement executed on March 24, 1988, the parties agreed to arbitrate.

I understand that there were separate documents, certain documents were signed by certain parties, but our contention is that the documents, the individual documents which made up the workout agreement were executed at the same time for the same purpose and according to the law we provided the court in our brief, they constitute essentially a single agreement. And the arbitration clause in the subordinate loan agreement —

THE COURT: Yeah, it refers to all of them, doesn't it?

MR. McDERMOTT: Yes, incorporates the letter agreement which was signed by Mr. and Mrs. Kaplan and we believe that that provides a separate and additional basis for arbitrable jurisdiction.

In addition —

THE COURT: You're talking about the agreement regarding the tax refund?

MR. McDERMOTT: I'm sorry?

THE COURT: I'm sorry. You're talking about the agreement regarding the tax refund?

MR. McDERMOTT: Yes, the letter agreement has a provision for the tax refund which is—and the letter agreement is one part of the, what the—what is referred to as the workout agreement. The subordinated loan agreement which was signed by MK Investments but which refers to the letter agreement included the arbitration clause.

In addition, in that—that provides a basis for jurisdiction over Mrs. Kaplan and Mr. Kaplan as well. In addition, after the action was filed and Mr. and Mrs. Kaplan withdrew their jurisdictional objections, we contend that that constitutes a submission to the jurisdiction of the Exchange.

THE COURT: Even if they were later reasserted?

MR. McDERMOTT: Well, I think once submitted, always submitted. It's —

THE COURT: You're losing me on the curve here. In other words, if somebody files a motion, say in a court case in Federal District Court, saying, you know, we move to dismiss, we don't think there's any personal jurisdiction and they then say: you know, we're going to withdraw that motion. But then they re-file it a month later, they're not allowed to do that? If they get a new lawyer they're not allowed to re-file it?

MR. McDERMOTT: I think that the difference is, your Honor, the concept of arbitrable jurisdiction and a Court's jurisdiction. If the Court—if a Court lacks jurisdiction over a particular matter, there's not a whole lot the parties can do —

THE COURT: I'm not talking about subject matter jurisdiction, I'm talking about in personam jurisdiction. Well, let's make it easy: they objected to jurisdiction, they withdrew their

objection, they got a new lawyer and he reasserted that objection, isn't that what happened?

And I want to make certain I understand your argument about why I should disregard the reassertion of the objection.

MR. McDERMOTT: Well, I—the fact that the objection was withdrawn and then approximately two years later was --

THE COURT: Yes, but before anything had happened except for one conference of some kind.

MR. McDERMOTT: There wasn't —

THE COURT: I think your adversary would agree that if you object to jurisdiction, withdraw it and then reassert it only after the conclusion of all the proceedings, it might not be very viable. But if I understand the record—and you've agreed to it—they reasserted an objection to jurisdiction before anything substantive happened.

I understand a long period of time elapsed, but from what I could ascertain, nothing happened during that period except some conference or other.

MR. McDERMOTT: There was—the objection was withdrawn in the beginning of a conference and they thereafter participated in the conference.

THE COURT: Right. And nothing else ever happened again, if I under-- of substance before they got a new lawyer who asserted or reasserted the objection, isn't that correct?

MR. McDERMOTT: It is correct that nothing, nothing substantive happened --

THE COURT: Right.

MR. McDERMOTT: —before the arbitration committee or the arbitration panel, that is correct.

THE COURT: Well, why then should I disregard the reassertion of the objection?

MR. McDERMOTT: Well, I think that the—and I'm not asking you to disregard the assertion of the objection as much as I'm asking you to concentrate on the withdrawal of the objection and I think that that withdrawal of their objection to jurisdiction was a clear indication that they were submitting to the jurisdiction of the Exchange.

THE COURT: Well, just humor me for a minute. What was the reassertion of the objection an indication of?

MR. McDERMOTT: I think it was an indication that they had changed their minds, but I don't —

THE COURT: Are they allowed to change their minds?

MR. McDERMOTT: I think they are allowed to change their minds, but that doesn't mean that they can unsubmit themselves to jurisdiction. Once a party agrees to arbitrate a dispute, that party is bound to arbitrate the dispute. And where a party —

THE COURT: Well, we've come full circle. You're telling me I should give no weight to the reassertion of the objection.

MR. McDERMOTT: I think that the reassertion of the objection, when you start looking at that, you then look at the decision that the panel reached in regards to that reassertion of the objection and what the panel did was to deny their objections to jurisdiction at that point.

Now, we don't know exactly what basis, exactly upon what basis they made that decision, but it is certainly a reasonable conclusion to assume that they considered the objection had been waived. And —

THE COURT: You really lost me on that curve. I'm supposed to infer from the denial of the second objection that they found that the—I'm sorry—the Kaplans had waived their jurisdictional objection?

MR. McDERMOTT: That they —

THE COURT: Isn't it possible that —

MR. McDERMOTT: Yes.

THE COURT: Isn't it equally possible they found jurisdiction because they bought your other arguments?

MR. McDERMOTT: Yes.

THE COURT: They said oh, look at this, we think we have jurisdiction.

MR. McDERMOTT: It's entirely possible.

THE COURT: Look at the agreement, look at the arbitration clause, he's a member, we have jurisdiction.

MR. McDERMOTT: Yes.

THE COURT: Isn't it equally as possible that was a basis for their decision?

MR. McDERMOTT: Yes, that is—that is equally possible and I think that that's—that's an important point in looking at what we're here to do today and that is not to, if the arbitrators had—if there is a plausible explanation for the decisions that the arbitrators reached, then that decision should be upheld.

THE COURT: You're losing me on the curve completely now. If there was an objection to jurisdiction, and if there was not a waiver of the right to judicial review on that point, then would it not be fair to say that the standard of review would be somewhat broader than the standard of review would be if there had been no waiver?

MR. McDERMOTT: I —

THE COURT: I mean then you get into Judge DuBois' analysis —

MR. McDERMOTT: Right, the cases —

THE COURT: —where then you treat it the same as any other issue.

MR. McDERMOTT: A manifest disregard —

THE COURT: In other words, unless they were completely off the wall, then you affirm them.

MR. McDERMOTT: Right, a manifest disregard of the law standard and that's my point, your Honor, is that there are a mult— there are a number of bases upon which they could have legitimately denied that jurisdictional—those jurisdictional objections when they were raised again.

THE COURT: I understand, but maybe I'm failing to be sufficiently cogent. The question is did the Kaplans waive their objection to jurisdiction? If they did, we may go down one path in terms of the scope of review. If they didn't, then you have a much broader scope of review, is that correct? So the question --

MR. McDERMOTT: Yes.

THE COURT: —the question is did they waive? Now, they objected and they withdrew the objection and I'm having a hard time understanding what you contend the significance, if any, was of their reassertion of a jurisdictional objection before any substantive proceedings on the merits transpired.

MR. McDERMOTT: Let me—let me try to break it down into steps. I think that once they withdrew the jurisdictional objection, the Kaplans thereby submitted themselves completely to the arbitration of this matter before the panel.

Thereafter they participated —

THE COURT: Well, stop there. Is that your way of telling me that once you consent, you cannot unconsent? I just—

MR. McDERMOTT: I think yes.

THE COURT: I mean, I'm not really trying to trick you, but I am desperately trying to understand your argument and having a very hard time understanding it. I mean, I'm not—there's at least three different things you may be telling me and I can't quite figure out what they are.

I mean, did I completely disregard the reassertion of the objection because you can't reassert an objection once it's withdrawn? Or it does have some significance, but you can't quite tell me what the significance is and why it's outweighed by something else? I just don't really understand.

MR. McDERMOTT: I think my problem is, your Honor, that I'm arguing two points in the alternative and I'm not separating them sufficiently.

My first point is that the withdrawal of the objection was a full and complete submission to the arbitration of the Exchange, a waiver, a complete waiver of their ability to contest the jurisdiction of the Exchange, given their clear indication of submission to the Exchange's jurisdiction.

Now —

THE COURT: Do you any authority for the proposition that before they actually proceed to arbitration, they have no legal right to change their mind and reassert their jurisdictional objection.

MR. McDERMOTT: I am not aware of whether we cited a case in our brief.

THE COURT: Well, it doesn't have to be in your brief, are you aware of any authority anywhere? You can give it to me right now.

MR. McDERMOTT: Well, if I cited in my brief, I can look it up an give it to you.

The best, the best I can tell you is I believe I have seen cases to that effect, but obviously I'm not—I just don't have them.

THE COURT: Just don't recall where you saw them?

MR. McDERMOTT: Right.

THE COURT: Well, again, at the risk of being redundant, I'm going to try one last time: what significance, if any, are you asking me to give to the subsequent reassertion of the jurisdictional exemption? Are you telling me disregard it, it's null and void, once they withdraw their objection they had absolutely no right to reassert it? Or are you telling me that based on their

conduct and the whole record and other things, I can find waiver even if I do attach some weight to the subsequent reassertion? Which of these things are you telling me or are you telling me some other thing?

MR. McDERMOTT: I think, your Honor, I'm telling you both in the alternative and I think that that's—I think what it comes down to is —

THE COURT: Well, fine, if that's your answer, then tell me what else I should look at in determining that despite a reassertion of the jurisdictional objection, they nevertheless waived it. What should I look at to agree with you on that point?

MR. McDERMOTT: The parties' conduct in —

THE COURT: Let me have it; what conduct?

MR. McDERMOTT: The waiver of the objections, the participation in the hearing. I—what happens is after you get past the waiver and the participation in the hearing, their reassertion of objections to jurisdiction are not meaningful in any sense.

THE COURT: But I thought we all agreed they participated in the hearing only after they renewed their jurisdictional objection?

MR. McDERMOTT: No, no. There was a—there was a pre-hearing conference scheduled in February of 1990.

THE COURT: Right.

MR. McDERMOTT: That hearing was—at that hearing, at the beginning of that hearing —

THE COURT: That's when they withdrew their original objection. That was reasserted before there were any proceedings, wasn't it?

MR. McDERMOTT: There was a proceeding following that withdrawal of the jurisdictional objections.

THE COURT: Well —

MR. McDERMOTT: That day.

THE COURT: Yeah, I understand, it was a pre-hearing conference and I'm not sure what that means, but before proceeding to arbitration, before actually proceeding they renewed their objection, didn't they? Now, what did they do therewith or thereafter that would evidence nonetheless a waiver of their jurisdictional objection or wavier of their right to pursue it through judicial review?

MR. McDERMOTT: Well, at least as regards Mr. Kaplan, he had filed counterclaim in the action. That was filed—this was filed before the pre-hearing, the original pre-hearing conference that we're talking about, but nonetheless I think that's a clear indication that he is submitting himself to the jurisdiction of the arbitration panel in that he's seeking relief from the exact same panel in which he objects—to which he objects on a jurisdictional basis.

THE COURT: Anything else? Not that that may not be pretty good, but anything else?

MR. McDERMOTT: Up to that point, I think that's—those are, I think, big points.

THE COURT: And he did not withdraw the counterclaim after the objection was reasserted, did he?

MR. McDERMOTT: No, the counterclaim was never withdrawn and he proceeded to the hearing on the counterclaim.

THE COURT: Okay, anything else?

MR. McDERMOTT: I—I'd just like to touch on some of the points that Mr. Feder raised. Again just to point out some of the distinctions between the cases cited by Mr. Feder and the situation we have here, in Pennsylvania Power, the affiant (ph.) in that case —

THE COURT: I'm sorry, the what in that case?

MR. McDERMOTT: Affiant (ph.).

THE COURT: Oh.

MR. McDERMOTT: Consistently maintained throughout the hearing the—its position that the matter was not arbitrable, that that is clearly not the case in this situation.

In the Local 719 case cited, when the party—when the union submitted to the jurisdiction or submitted the issue of arbitrability to the arbitrators, they expressly stated that they were not waiving at that time—and this was at the beginning of the proceedings—they expressly stated that they were not waiving their right to seek further judicial review of this matter.

Again, that's not what happened here.

THE COURT: Well, wait a minute. The Kaplans here expressly voiced an objection to jurisdiction, didn't they?

MR. McDERMOTT: And then submitted that objection to the arbitrators to decide.

THE COURT: Well, the same thing in the Penn Gas case, they submitted the issue to the arbitrators, but they didn't waive the right to judicial review, at least that's what Judge Staple found, didn't he?

MR. McDERMOTT: I think that when you look at all the factors in this case, they sufficiently distinguish the cases cited by Mr. Feder. I don't think that this is a situation where the Third Circuit is so far away from the Second Circuit and other circuits. In fact, I think that much of the reasoning in the cases cited in their reply brief is sound law and consistent with many other circuits.

I think that simply the facts of this case distinguish those cases and make, for example, York Air a more applicable case.

THE COURT: Well, I don't know. They do say you need a clear indication, do they not?

MR. McDERMOTT: The —

THE COURT: Of a willingness to waive or forego judicial review.

MR. McDERMOTT: That is correct. And my argument in that regard would be that in this case we had a clear indication through the initial waiver of the —

THE COURT: All right, your argument is that where it's ambiguous and confusing, it doesn't necessarily satisfy the clear indication test, is that your position? Would you not acknowledge that it's at least somewhat ambiguous here what they intended to do?

MR. McDERMOTT: Certainly.

If I could, I'd like to go on to the arguments which concern the release language and whether there was a manifest disregard of law or of the contractual agreement.

The language in the release clause included a clause at the end of the paragraph, provided however if Mr. Kaplan doesn't —

THE COURT: I'm sorry, I'm just having trouble hearing you. If Mr. Kaplan doesn't what with some form?

MR. McDERMOTT: There was language at the end of the release paragraph concerning Mr. Kaplan.

THE COURT: You're talking about the release of prior liability? I'm not sure I understand what document you're talking about.

MR. McDERMOTT: In the workout agreement —

THE COURT: Oh.

MR. McDERMOTT: —there was a release —

THE COURT: From prior liability.

MR. McDERMOTT: Yes.

THE COURT: Yes.

MR. McDERMOTT: With a "provided however" clause which required him to perform under the agreement. The panel heard testimony offered from both sides as to what the release language meant. They considered, they were provided with and

considered various drafts of the agreement and again I think it's important to remember that this is a factual determination regarding what the parties agreement was which the arbitrators reached a resolution about.

Now, it is—it is unclear, since arbitrators don't provide written reasons with their awards, exactly what they based their decision on, but —

THE COURT: It doesn't matter what they based their decision on, does it? If I find there was no waiver, then I have to actually find there was jurisdiction, do I not?

MR. McDERMOTT: I'm sorry, if you find that there was no waiver?

THE COURT: Then I'd have to find there was actually jurisdiction, I have to find that you all agreed to arbitrate, don't I?

MR. McDERMOTT: Yes.

THE COURT: So it doesn't matter what reason the arbitrators appear to find they had jurisdiction without ever explicating it, I have to find they had jurisdiction, don't I?

MR. McDERMOTT: You—no, and, well, yes —

THE COURT: I don't?

MR. McDERMOTT: But what you have to find is that there is some basis in the record for the decision that the arbitrators reached. We don't necessarily—it doesn't—we don't necessarily —

THE COURT: Well, you're really losing me on the curve here. Your position is that when you go to arbitration, one of the parties says we object, we don't think there's an agreement to arbitrate, we don't think this is arbitrable, but in the first instance without waiving any rights, all right, you take a look at it, perhaps thinking you're bound to agree with us and we'll get this over with in a hurry.

Then they don't agree and they say: We find we have jurisdiction. They never tell you why, they just say we find it.

Your position is: I don't have to find whether or not they really had jurisdiction, I don't have to find whether the party really agreed to arbitrate, as long as they conceivably did, is that what you're telling me?

MR. McDERMOTT: No, no, it's not. And what I—I perhaps didn't speak as clearly as I should have--you are correct that you have to find a basis for the result reached by the arbitrators.

THE COURT: Don't I have to find that the parties agreed to arbitrate the dispute? And only then that we take a look at whether there is some probable basis in fact and law for the decision they reached on the merits?

MR. McDERMOTT: Yes. When I say the result that they reached, I include as part of that result the determination on the fact that there is some jurisdiction and simply you have to find a basis for the award that they reach and that includes jurisdiction.

THE COURT: Well, we've come full circle here. What if they have it waived? Generally, it's up to the courts to decide, it is not, whether a matter falls within the jurisdiction of an arbitrator?

MR. McDERMOTT: At first blush, yes, unless there is, unless there is some conduct—well —

THE COURT: There's only one exception, isn't there?

MR. McDERMOTT: Well, the parties can agree to submit the issue to the arbitrators.

THE COURT: Right, right. But what if—my question for you which I'm sure it's my fault for not being able to articulate well, that supposing I find that like in some of the circumstances described in some of the Third Circuit cases we have alluded to, they said hey, we contest jurisdiction, we don't think this dispute is arbitrable. Now, without waiving any rights and without agreeing to forego ultimate judicial resolution or at least we're not going to clearly indicate that we're waiving, go ahead, we'll let you take a crack at it. And the arbitrators come back and say

well, jurisdiction, and they proceed to adjudicate the merits, just what happened in two of these five Third Circuit cases, isn't it? You're telling me that when it gets to me, all I do is look to see whether there's any colorable basis at all for their finding that they had jurisdiction? Or do I actually have to find that they did have jurisdiction?

MR. McDERMOTT: I believe —

THE COURT: Or aren't you sure?

MR. McDERMOTT: I believe that it is the former, there is—there is a colorable basis for the Court, for the arbitrators finding they had jurisdiction when the parties had submitted that question.

THE COURT: No question about it because that's then the test you apply to every finding. My question is they haven't agreed, they've objected, they have filed a motion,n they've said there's no jurisdiction, this is not arbitrable, we never agreed to arbitrate, but then as apparently happened in at least two of these cases the Third Circuit got, they go ahead without waiver and they let the arbitrators find jurisdiction and enter an award.

What I'm reaching for is what's the test then, is it still any colorable basis or do I actually have to find there was jurisdiction?

MR. McDERMOTT: Well, I think there is some disagreement in courts as to what the standard is to be applied, but I think that there is—and I believe it was the International Brotherhood case where the Court would—the Court indicated that they would have to clearly perceive that the arbitrators lacked authority or lacked jurisdiction in order to conclude that or in order to vacate the arbitration award. And I think that the language they used indicates that it is a higher standard than simply reweighing the evidence de novo. I think that it is a—it is a higher —

THE COURT: Even where a party has objected to jurisdiction and not waived that objection?

MR. McDERMOTT: If the party from the start submits the question of arbitrability to the arbitrators but at that time says

I retain the ability to seek judicial review of this determination, in that situation I think that there should be a de novo review in the Court and in fact that was the Local 719 case.

THE COURT: Right.

MR. McDERMOTT: I do not think that the situation which we have here where the parties did not consistently maintain their objection, they subsequently —

THE COURT: So it turns on the facts as we find them, doesn't it? It turns on whether or not they preserved their right or failed to waive the right or however you characterize it to see judicial resolution, isn't that—on this issue? Isn't that what it comes down to? That will determine what the scope of review is, won't it?

MR. McDERMOTT: Yes.

THE COURT: So assuming, just maybe I get to the question of is there jurisdiction, what am I supposed to look at? I'm supposed to look at the arbitration provision and the workout agreement, anything else? The fact that Mr. Kaplan is a, quote, "member"?

MR. McDERMOTT: The Exchange rules.

THE COURT: Within the meaning of the definition of the rules. Anything else?

MR. McDERMOTT: Well, I do think that the—the withdrawal of the objections themselves constitutes a separate submission, but yes, the agreement and the Exchange rules, I think, provide the basis in this case.

THE COURT: Okay, anything else?

MR. McDERMOTT: At least in terms of jurisdiction I think that sums up.

THE COURT: Any other points you wish to address?

MR. McDERMOTT: I would like to briefly address some of the point raised at this time about the questions of bias.

The—regarding the vacatur of a discovery order, the one thing which was quite clear from Mr. Feder's discussion of this issue I think was that First Options did not know at the time of the first pre-hearing conference that Mr. Waber was participating on the committee that was actually hearing the dispute, as the affidavits which we've submitted indicate it was in December of 1991 that First Options found out about this participation.

Regarding the —

THE COURT: You knew he was on some other committee? I guess I —

MR. McDERMOTT: No, he was on the arbitration committee. The arbitration committee in toto does not necessarily sit in each instance, they meet in fact according to the rules, they simply have to meet by quorum. And so —

THE COURT: Say that again?

MR. McDERMOTT: According to the rules then in existence, they had to meet by a quorum.

THE COURT: Well, you knew—was he one of the seven people?

MR. McDERMOTT: At the time there was an arbitration committee which was a different situation than we had under the new rules which established arbitration panels. Under the old rules the arbitration committee, which was a larger group of people —

THE COURT: How many?

MR. McDERMOTT: I believe it was 20. The —

THE COURT: In other words, saying what? You have a committee of 20 people, they don't hear all disputes, they pick three or five or seven of them to hear a dispute, is that what you're saying?

MR. McDERMOTT: No, it's not, they simply have to, it's like any large committee, to conduct business they have to have a quorum there and they're not—they weren't assigned panels

to hear a dispute, they simply had to have a quorum of the committee to conduct one.

THE COURT: So 20 people would hear a dispute?

MR. McDERMOTT: That was why they got new rules.

THE COURT: Any they could not proceed unless what, 11 or more were present?

MR. McDERMOTT: I don't mean to represent to the Court that I know the exact number of people, it was a larger number than the seven-person panels that we have assigned to the case.

THE COURT: Well, did a quorum require at least a numerical majority?

MR. McDERMOTT: Yes.

THE COURT: So you needed at least 11 people, is that right?

MR. McDERMOTT: Right.

THE COURT: But they didn't have to be the same 11 people? This is how they ran their arbitration program?

MR. McDERMOTT: That's my understanding.

THE COURT: So we had five days of testimony. Different people may hear different testimony each day? I'm on the committee, I can make it Monday and Wednesday, but not Tuesday, Thursday and Friday. So I know whatever the testimony was on Monday and Wednesday, but not Tuesday, Thursday and Friday? This is how they ran their arbitration program?

MR. McDERMOTT: In terms of individual hearings, hearings regarding a particular matter, I have to confess, your Honor, I don't know about the rules as to how they used to run the system, but my understanding was on that particular day for the hearing it was uncertain as to whom for the committee would actually be on the panel or on the—sitting on the committee —

THE COURT: Well, the reason I'm asking how it worked is because it at least appears that you at least knew that Mr. Weber or Waber or however he pronounces his name, well, could have been one of the people, since apparently this was a committee of the whole and as long as 11 or more people showed up, it was off to the races?

MR. McDERMOTT: I think that's true. I mean, it is, it was conceivable that he could have sat on the committee, although one would also presume, I think, that he would have rescued himself from the matter, given his relationship with one of the parties?

THE COURT: But you later learned he didn't?

MR. McDERMOTT: Excuse me?

THE COURT: You later learned he did not?

MR. McDERMOTT: Correct, in December of 1991.

THE COURT: So if it's a committee of 20, if it takes a minimum of 11 people and that means it takes a minimum of 6 people to make a decision, Mr. Waber would have been a powerful advocate to get them to enter [illegible] appeared shortly thereafter to be clearly erroneous [illegible] you agree with that?

MR. McDERMOTT: I don't know what kind of any advocate Mr. Waber was and in fact I don't know that he would have had to have them render a decision that was clearly erroneous. The arbitration panel wasn't under a clearly erroneous standard reversing the earlier decision and in any event the issue here is not whether the decision which the arbitration panel made vacating that earlier order was clearly erroneous or erroneous at all. The issue is whether —

THE COURT: Well, maybe I was being a little hyperbolic, but why don't you go on and continue with the prejudice argument or the partiality argument?

MR. McDERMOTT: Okay. And again I'd just like to point out there with all of these issues, the question is whether they prejudiced the petitioners.

THE COURT: Well, where do I find that standard?

MR. McDERMOTT: I believe that that's the standard in determining —

THE COURT: It's not in the act, is it?

MR. McDERMOTT: It's in the case law and should be in the act.

THE COURT: Where, under the second criteria?

MR. McDERMOTT: Under the—oh, the bias?

THE COURT: Are you sure if I find evident partiality I then have to find actual prejudice, are you sure? Or is it possible that I don't?

Well, go ahead, consult with co-counsel, maybe he'll have some light to shed on it.

MR. McDERMOTT: I believe that if the order resulting from the arbitration proceeding—if the parties were not prejudiced by the decisions made by the panel which are raised in these 14 points, then the award should be affirmed. If you do find —

THE COURT: Well, let's take the other half of No. 2. If I found that the arbitrators were clearly corrupt, I should go ahead and affirm the award, according to you, as long as there was no actual prejudice, right?

MR. McDERMOTT: That's the point I was about to make, Judge. If the individual decisions that they made did not cause prejudice then—or did not cause prejudice to them, then the award has to be confirmed.

If you find evident partiality on the part of the arbitrators, that is, under the act, the basis for vacating the award.

THE COURT: Without regard to prejudice, right?

MR. McDERMOTT: That—in regards to the prejudice part of the two points, yes.

THE COURT: Well, humor me. I thought we were talking about evident partiality, isn't that what—weren't we under that portion of the argument?

MR. McDERMOTT: Yes, and —

THE COURT: Well, help me out here. Is it your position I have to find actual prejudice plus evident partiality or just evident partiality?

MR. McDERMOTT: I believe that the standard is that ...

(Pause.)

THE COURT: Well, go ahead. I don't want to wait while you read through things. I thought maybe you'd have an answer off the top of your head.

Okay, anything else?

MR. McDERMOTT: To answer the question, I think you have to find a reasonable impression of partiality.

The other —

THE COURT: Assuming that the test is evident partiality, period, would you agree that looking at all these 14 things a reasonable person would be forced to conclude that the arbitrators were impartial or partial? Excuse me, partial. Humor me for the moment, let's assume you don't need prejudice, let's assume you just need evident partiality. My question is would you agree that taking the 14 points the Kaplans complained about together —

MR. McDERMOTT: Mm-hmm.

THE COURT: —a reasonable person would be forced to conclude that the arbitrators had been partial?

MR. McDERMOTT: Well, I think it's—I think that the taking all, even taking all 14 points together that they don't indicate any partiality on the part of the arbitrators.

THE COURT: Do you have any argument to make on that point at all? You don't have to.

MR. McDERMOTT: Well, I think if you go through each individual point you see that it becomes clear that most of the allegations of prejudice —

THE COURT: No, these are allegations of partiality.

MR. McDERMOTT: Most of the allegations of partiality, if you look at what is being alleged to have occurred in context of what happened, it just doesn't—that most of these individual instances don't indicate partiality in any respect.

THE COURT: Do any of them?

MR. McDERMOTT: I don't think so.

THE COURT: Okay, anything else?

MR. McDERMOTT: I would just like to refer you again to the discussions in the parties' briefs as to each of those points and I think that that does a fairly good job of pointing out how there is no prejudice as to each of those or partiality as to each of those points.

THE COURT: Well, they say that these arbitrators wouldn't even let them cross-examine one of your key witnesses. That's unusual, isn't it?

MR. McDERMOTT: The only witness they were not allowed to cross-examine was Gary Wendice on his rebuttal testimony. He had in fact been cross-examined earlier on his testimony during First Options' case in chief. They didn't, he was not allowed cross-examination, they were not allowed cross-examination on the rebuttal testimony, but then neither was First Options allowed direct examination on rebuttal, rather the arbitrators decided at that point what they were seeking and asked the questions and I don't think either party, I don't think the procedure that they picked in not allowing either party to question him evidences any partiality on their part.

THE COURT: I thought they wouldn't let them, they say that they wouldn't let them cross-examine one of your key witnesses, an expert witness or something?

MR. McDERMOTT: They—they attempted to question —

THE COURT: They cut them off after two questions or something?

MR. McDERMOTT: They attempted to question Scott Talento regarding an issue of—regarding the Seymour Spector issue, Seymour Spector was the witness, the expert witness which the petitioners had subpoenaed to appear at the hearing, at the beginning of the hearing the parties presented their arguments as to the propriety of that subpoena. Before the arbitrators ruled on the propriety of the subpoena, the subpoena was—the petitioners withdrew Mr. Spector as a witness and when Mr. Talento was testifying—

THE COURT: I mean, I assume, I've got to read between the lines, but I assume they wanted to adduce evidence that somebody had leaned on Mr. Spector to get him to withdraw his favorable testimony and that that's why they weren't able to call him.

MR. McDERMOTT: Well, the point is that they had withdrawn Mr. Spector as a witness. They wanted to attempt to enforce the subpoena and have him testify, they could have done that.

THE COURT: I think their position is they didn't want to because after agreeing to give favorable testimony, somebody leaned on him and got him to back off. But they thought maybe establishing that fact could be material in some way. That's my impression, but maybe I'm reading too much between the lines.

Anything else?

MR. McDERMOTT: I've got one last point which was one of the points raised by Mr. Feder regarding insensitivity to Mr. Kaplan's religious practices, I would just like to point out that the hearing had been originally scheduled in 1991, had been rescheduled on numerous occasions and it was only, and on each of those occasions both Friday and Saturday hearings had been scheduled. It was only after it was again finally scheduled for the

May hearing that the point was raised regarding a limitation of that Friday.

THE COURT: Well, I'm not sure I follow. You're saying that they attempted to schedule a hearing on a number of occasions?

MR. McDERMOTT: That the hearing had been originally scheduled, I believe, in fall of 1991 for specific dates. It was then continued to December of '91—no, I'm sorry—it was continued to January of '92 and then February of '92 and then April and May and there were Friday and Saturday hearings scheduled on all of those instances and it was—the point was never raised as to whether Friday or Saturday hearings needed to be restricted in any way until it was first raised when a hearing had been scheduled for April.

THE COURT: Is that unusual for the arbitrators to meet on Friday and Saturday?

MR. McDERMOTT: That's not my understanding. In fact, I think it's rather normal, the arbitrators —

THE COURT: Cause they like to work and make a living Monday through Friday, right?

MR. McDERMOTT: Exactly. And in addition to the, well, I just think the point is that the issue wasn't raised until they got into a final hearing date and at that point I think it was eminently reasonable for the Exchange not to again switch the dates. If your Honor has any questions regarding any other specific points, I'd be happy to address them, but I think that the briefs do an adequate job of addressing every point that's been raised.

THE COURT: Okay. We'll take it under advisement.

MR. FEDER: Your Honor, with trepidation, one factual point, not a rebuttal argument.

There is nothing in the record regarding how many members of the full arbitration committee there are, my understanding it's 11 and there's nothing in the record.

THE COURT: Oh, I see. Well, I guess that's my fault for asking too many questions. I just thought it would be interesting to try to figure out what I might be able to look at in trying to determine whether First Options should or should not have known that Mr. Waber may have been a party to the ruling that was later vacated. I'm not sure it's all that pertinent.

All right, is there anything else at all? Okay.

Do you agree with Mr. Bedell that it's not good enough if I find partiality; I have to find that it actually prejudiced your client?

MR. FEDER: Your Honor, I rarely agree with Mr. Bedell. Mr. McDermott is my opposing counsel today.

THE COURT: Oh, I'm sorry.

MR. FEDER: I occasionally agree with him.

THE COURT: I'm sorry.

MR. FEDER: And I do not agree, no. I know of no case that says that.

THE COURT: And I guess the other question I would ask you, just so the record is clear, everybody got their chance, do you agree that in determining whether or not the arbitrators in this case had jurisdiction I have to defer to them if there was any colorable basis on which they could find they had jurisdiction that ends the inquiry?

MR. FEDER: No, sir, I believe you have that obligation to review that question de novo.

THE COURT: Unless it was submitted and waived, correct?

MR. FEDER: If it was submitted and waived, then you would review it on a deferential basis.

THE COURT: Like you would any other finding, right?

MR. FEDER: Yes, sir.

THE COURT: All right. Well, my apologies to Mr. McDermott for giving him a misnomer.

MR. McDERMOTT: No offense taken, your Honor.

THE COURT: I will take this under advisement. Based on the inches of paper submitted—might be up to feet now—I can't promise you that there will be a prompt ruling, but there will be one reasonably soon.

Now, if you ask me to get more specific, I probably can't, but it will not be in a matter of days but hopefully it will be in a matter of a couple of weeks. Now, knowing that, let me ask Mr. McDermott and his colleagues, is there any reason we need to proceed to schedule and take testimony on the motion for preliminary injunction?

MR. McDERMOTT: Your Honor, I think that at this point, given the promptness in which you were able to schedule this hearing and your statements regarding the relevant quickness in getting to a conclusion of this matter, I think at this point preliminary injunction has been essentially mooted and I would be happy, with your permission, to withdraw it or you can consider it moot or whatever your preference is.

THE COURT: Oh, I don't think you need my permission to withdraw it. I don't even think a response has been filed to it, but —

MR. FEDER: Your Honor, we did file an objection— a response, but we'd have no objection to it being withdrawn.

THE COURT: Oh, well, then I'm afraid you can't withdraw it without their consent, which I have a feeling you could probably obtain easily.

MR. FEDER: No price.

THE COURT: Well, all right, then we'll treat—well, let's make sure the record's clear. You're moving at this time to withdraw the motion for preliminary objection?

MR. McDERMOTT: I am.

THE COURT: Excuse me—preliminary injunction?

MR. McDERMOTT: I am, your Honor.

THE COURT: And you're consenting?

MR. FEDER: No objection.

THE COURT: All right. Well, under whatever the rule is, I think it's—what is it, 41(A)(2) or something or other? I'll look it up and get the rule right. Whatever rule it is, under the rule we'll grant your motion.

Yes, sir?

MR. McDERMOTT: If I may, one other point, you had expressed an interest in conclusions of law?

THE COURT: Oh, no, no, not an interest. I'm positively requiring them. This is Wednesday, I believe—yeah, it is Wednesday. I would like to get your proposed conclusions of law as quickly as possible. I mean, if you really want to get this done expeditiously consistent with my other obligations and cases and so forth, I don't see why you couldn't get these in within 24 hours. I thought I would have them today.

I mean, if you could get all the stipulations of fact together in 24 hours, it ought to be easy to get your proposed conclusions of law together, you ought to already have them. You just need to, I assume, put them in the form of proposed conclusions. I mean, if you all don't know what principles of law you think are applicable at this point, then I don't know that you ever will. So why don't you try to get those in tomorrow?

MR. McDERMOTT: I think that's—that's fine. I am flying back to Chicago tonight, but I don't think that's a problem.

THE COURT: Oh, that's only going to take you about three hours and then you pick up an hour on the clock. You know, what the heck, you could—let's see, that would be about 8:30, 7:00, you could probably be in your office by 9:00 o'clock central time tonight.

MR. McDERMOTT: I'm sure Mr. Bedell would appreciate that.

THE COURT: Well, I'm sure he might. All right, I'm going to adjourn and I'll take the matter under advisement.

MR. FEDER: Thank you, your Honor.

MR. McDERMOTT: Thank you, your Honor.

(Court adjourned at 5:15 p.m.)

* * *

Supreme Court, U.S.
FILED
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(6)

No. 94-560

In the Supreme Court of the United States

OCTOBER TERM, 1994

FIRST OPTIONS OF CHICAGO, INC., PETITIONER

v.

MANUEL KAPLAN, CAROL KAPLAN & M.K. INVESTMENTS, INC., RESPONDENTS

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF FOR THE PETITIONER

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QUESTIONS PRESENTED

1. Whether a court reviewing an arbitration award under the Federal Arbitration Act should apply a *de novo* standard of review or the more deferential standard applied to arbitrators' decisions on the merits when reviewing the arbitrators' decision on arbitrability where the party objecting to arbitral jurisdiction had submitted the issue to the arbitrators for decision, as to which the courts of appeal are in conflict.

2. Whether the United States Courts of Appeals should apply a *de novo* or an abuse-of-discretion standard of appellate review to a district court's decision denying a petition to vacate an arbitration award and granting a cross-petition to confirm an award, as to which the courts of appeal are in conflict.

RULE 29.1 STATEMENT

Petitioner First Options of Chicago, Inc., is wholly owned by SLK Acquisition Co., which is in turn wholly owned by SLK Holdings, Inc. SLK Holdings is wholly owned by Spear, Leeds & Kellogg, a limited partnership. First Options has no non-wholly owned subsidiaries.

At the time this case arose, First Options was owned by Continental Bank, N.A.; Continental Bank retained its interest in this case when it sold First Options in 1991. In 1994, Continental Bank became part of Bank of America National Trust & Savings Association ("Bank of America"), the corporate parent of which is BankAmerica Corporation. Bank of America has one subsidiary that is not wholly owned by Bank of America affiliates, which is Ontario Limited.

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A53) is reported at 19 F.3d 1503. The opinion of the district court (Pet. App. C1-C32) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on March 31, 1994. A timely petition for rehearing was denied on June 29, 1994. The petition for a writ of certiorari was filed on September 27, 1994, and was granted on December 5, 1994. The jurisdiction of this Court rests on 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant provisions of the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, are set forth in a statutory appendix to this brief, at 1a-5a.

STATEMENT

1. The Parties and their Market-Maker Agreement

Petitioner First Options of Chicago, Inc. ("First Options") is a clearing member of the Philadelphia Stock Exchange (the "Exchange") and of other securities and commodities exchanges. As a clearing firm, First Options provides administrative support and risk control services to customers who open trading accounts with the company. First Options has considerable financial exposure in the event its customers incur losses because it guarantees to the Exchange and to persons with whom its customers trade that its customers' positions will be covered. Pet. App. A4-A5.

Respondent MKI Investments, Inc. ("MKI") was one of First Options' customers. MKI was a member of the Exchange and an "options market maker," trading options

for its own account. It was controlled by respondent Manuel Kaplan, who was president, a director, and sole shareholder of the company. Mr. Kaplan was also a member of the Exchange in his own right until December 1987. Carol Kaplan is Manuel Kaplan's wife. Pet. App. A4-A5, C4.

MKI's relationship with First Options was governed by a 1984 Market-Maker Agreement, in which First Options agreed to clear MKI's trading account and MKI agreed to repay any deficiency in that account. The agreement protected First Options by providing that the company had the right to liquidate MKI's positions "whenever in [First Options'] discretion [First Options] deem[ed] it necessary." The Market-Maker Agreement also provided that "any controversy * * * arising out of [MKI's] business or this agreement" was to "be submitted to and determined by arbitration." Pet. App. A4-A5.

2. The October 1987 Stock Market Crash and its Aftermath

In mid-October 1987, MKI's trading account with First Options had an approximately $10.5 million credit balance. Then, on October 19, 1987, the stock market plummeted. By the end of the trading day MKI's account showed a deficit of $2.1 million. Because First Options guaranteed all positions in MKI's accounts, First Options was at risk on the full amount of that deficit and any subsequent losses. Pet. App. A5.

Although MKI faced significant risk of further losses in its account, Mr. Kaplan refused to cooperate with First Options in reducing that risk. Instead, he barricaded himself in MKI's offices and declined to communicate with First Options' staff. Pet. App. C3. First Options therefore exercised its right under the Market-Maker Agreement to take control of MKI's account and to liquidate positions in the account that it deemed to pose unacceptable risks. As a

result of First Options' liquidation of MKI's positions, the account deficit increased to some $5.1 million. A deficit in another account and unpaid brokerage fees brought MKI's total indebtedness to First Options to $6,227,188. *Id.* at A6-A7, C3. This debt left MKI insolvent. *Id.* at A51, C29.

Unbeknownst to First Options, MKI nevertheless had substantial cash in a bank account controlled by Mr. Kaplan. Instead of using this cash to repay MKI's creditors, Mr. Kaplan withdrew $611,300 between October 19 and December 18, 1987. Pet. App. A51, C29; C.A. App. A972. Mr. Kaplan made these withdrawals, First Options' accounting expert testified before the arbitrators, at a time when he owed MKI about $2.2 million for outstanding loans he had taken from the corporation. C.A. App. A1068-A1069. There was thus evidence, as the district court noted, "that Mr. Kaplan disregarded corporate formalities and siphoned corporate funds." Pet. App. C29; see also *id.* at C28-C29 (discussing evidence that Mr. Kaplan commingled MKI's funds with his own).

3. The Workout Agreement

Unaware of MKI's cash reserves, of Manuel Kaplan's withdrawals of funds, or of the financial position of Kaplan and his company, First Options negotiated a workout to try to secure repayment of the nearly $6.25 million it was owed. On March 24, 1988, First Options, MKI, Manuel Kaplan, and Carol Kaplan agreed on the terms of a workout, executing a Letter Agreement (signed by all four parties), a Guaranty (obligating MKI), a Subordinated Loan Agreement (executed by First Options and MKI), and a Subordinated Promissory Note (executed by MKI) (together, the "Workout Agreement"). The Subordinated Loan Agreement contained a broad arbitration clause that on its face applied to the Letter Agreement signed by the Kaplans (Pet. App. C12):

> any controversy arising out of or relating to this Agreement, the Letter Agreement, the Subordinated Notes or any other document referred to herein or therein or the breach thereof shall be submitted to and settled by arbitration pursuant to the Constitution and Rules of the Exchange. The parties hereto and all who may claim under them shall be conclusively bound by such arbitration.

Under the terms of the Workout Agreement MKI agreed to repay its $6.25 million debt to First Options; MKI transferred four Exchange memberships to First Options; MKI and Mr. Kaplan contributed $900,000 to a new trading account, which MKI resumed trading; Mr. Kaplan paid First Options $80,000; Mr. and Mrs. Kaplan agreed to remit to First Options their 1987 tax refund, estimated to exceed $300,000; and MKI agreed to split its trading profits with First Options. Pet. App. A7-A8.[1]

Pursuant to the Workout Agreement, MKI resumed trading in April 1988. Its account soon sustained additional substantial losses. On January 16, 1989, MKI lost $1.5 million on its "short call" positions in the options of a single stock. First Options requested that MKI act to reduce risk in its account, but Mr. Kaplan failed to do so and was unresponsive to First Options' concerns. First Options therefore once again took control of MKI's account and liquidated the positions in the account, leaving an additional deficit of $65,000. Pet. App. A8-A9, C4-C5. After Mr.

[1] Mr. Kaplan represented that he had borrowed $500,000 of the $900,000 contributed to MKI's new trading account, which had the effect under the Workout Agreement of according the lenders priority over First Options in their claim to MKI's equity. In fact, the evidence proved that Mr. Kaplan provided these funds himself. Pet. App. A49, C30; J.A. 7-8.

Kaplan refused to allow First Options to inspect MKI's books or the Kaplans' tax returns, or to pay First Options the Kaplans' 1987 tax refund, First Options declared an acceleration of the debt and demanded repayment of the entire amount due under the Workout Agreement. *Id.* at A9. When this demand, too, went unsatisfied, First Options submitted its claim to the Exchange for arbitration.

4. The Arbitration Proceeding

On July 1, 1989, First Options filed a Statement of Claim with the Exchange alleging that respondents had violated the Workout Agreement. First Options' claim sought damages in excess of $300,000 against the Kaplans for failure to remit their 1987 tax refund to First Options. It also requested damages of nearly $6.3 million against MKI, as well as against Manuel Kaplan personally. First Options alleged that Manuel Kaplan was individually liable for MKI's debt because (i) Kaplan was the controlling person of MKI and all MKI's activities were for his benefit, and (ii) MKI was Kaplan's alter ego and instrumentality. First Options' grounds for asking the arbitration panel to pierce MKI's corporate veil to award damages against Mr. Kaplan were that Kaplan had inadequately capitalized the company, had disregarded corporate formalities, and had treated MKI's assets as his own. Pet. App. A10, C5; C.A. App. A62-A71.

MKI and First Options thereafter signed an agreement, separate from the arbitration clause in the Subordinated Loan Agreement, submitting the case to the Exchange for arbitration. The Kaplans did not sign a submission agreement. Pet. App. A10. First Options believed that the Exchange nevertheless had jurisdiction over the Kaplans on four distinct grounds. *Id.* at A23-24, A43, C12-13. First, for the same reasons that MKI was the alter ego of Mr. Kaplan, rendering him liable for MKI's violation of the Workout Agreement, Mr. Kaplan also was subject to jurisdiction of the Exchange

through MKI. Second, the Kaplans were bound by the arbitration clause in the Subordinated Loan Agreement because that provision was an integral part of the Workout Agreement and was to be read together with the Letter Agreement to which it expressly referred and which the Kaplans had both signed. Third, Manuel Kaplan was an "associated person" of MKI as defined in the Securities and Exchange Act of 1934, 15 U.S.C. § 78c(a)(21), and as such was subject to Exchange jurisdiction under Exchange Rule 950, section 6(a)(2), which provides that "[a]ny dispute, claim or controversy * * * between and/or among members and/or associated persons * * * shall be arbitrated under these procedures." C.A. App. A289. Finally, the Exchange could exercise jurisdiction over Mr. Kaplan under Exchange Rule 950, section 6(a)(1), because he had been a member of the Exchange at the time of the stock market crash that necessitated the workout. *Ibid.*

The Kaplans filed objections to the Exchange's jurisdiction. At the same time, they answered First Options' claims, addressing the merits and denying liability. Mr. Kaplan also filed a counterclaim against First Options with the Exchange, seeking $10 million damages for interference with prospective business opportunities and libel and slander. Mr. Kaplan's counterclaim did not question the arbitrators' jurisdiction. Pet. App. A10-A11; C.A. App. A119-171. Subsequently, at the beginning of a pre-hearing discovery conference before the Exchange Arbitration Committee on February 26, 1990, the Kaplans withdrew their jurisdictional objections. Thereafter, they fully participated in the conference. Pet. App. A11, C15-16; C.A. App. A191.

For the next two years the case lay largely dormant. In January 1992, however, after they retained new counsel, the Kaplans filed a Motion to Dismiss for Lack of Jurisdiction and a supporting memorandum with the arbitration panel, claiming to "reiterate and renew" the objections that had

earlier been withdrawn and denying each of the four grounds of arbitral jurisdiction asserted by First Options. The Kaplans made this motion without reservation; nowhere in it did they claim that the arbitration panel should not decide the issue of its jurisdiction, or assert that jurisdiction should be ruled upon by a court in the first instance. C.A. App. A194-A205. Nor did the Kaplans decline to go ahead with the arbitration, or seek relief from the courts to prevent the arbitration from taking place. In an order dated January 14, 1992, the arbitration panel denied the Kaplans' Motion to Dismiss for Lack of Jurisdiction. Pet. App. A12; J.A. 39.

After the Kaplans' jurisdictional objections were rejected, the parties' claims and counterclaims proceeded to an eight-day, nineteen-witness evidentiary hearing before the arbitration panel. The panel rendered an award in favor of First Options on both the claims and counterclaims. The award noted First Options' contention that Manuel Kaplan "is the alter ego of MK Investments, Inc. on the basis of Mr. Kaplan's failure to maintain a separate corporate existence and fraud," and required MKI and Manuel Kaplan, jointly and severally, to pay First Options $5,662,188 plus interest. The arbitrators also found that Manuel and Carol Kaplan were liable under the Letter Agreement to remit their 1987 tax refund to First Options, and required the Kaplans, jointly and severally, to pay First Options $346,342 plus interest. Pet. App. A12; J.A. 40-43.

5. The District Court's Confirmation of the Arbitration Award

Respondents filed a petition to vacate the arbitrators' award in the district court pursuant to Federal Arbitration Act section 10 (9 U.S.C. § 10); First Options cross-petitioned to confirm the award under section 9 of the Act. In their petition, the Kaplans challenged the arbitrators' determination of jurisdiction. They argued that First Options' claims

against them were not properly arbitrable, that the panel had "exceeded its powers" when it took jurisdiction over them, and that the court should therefore vacate the award under Arbitration Act section 10(a)(4). Manuel Kaplan also argued that the panel had acted in manifest disregard of law when it determined that he was jointly and severally liable with MKI for violation of the Workout Agreement. The district court rejected these arguments and confirmed the award. Pet. App. C9-C18, C27-C30.

Stating that "[i]t is well-established that a party who voluntarily and unreservedly submits an issue to arbitration cannot later maintain that the arbitrators acted without authority to resolve that issue," the district court held that the Kaplans had waived their jurisdictional objections. Pet. App. C14. Rather than "consistently maintain[ing] an objection to the arbitration panel's jurisdiction," the Kaplans had filed a motion expressly asking the arbitration panel to decide the issue of jurisdiction and "expressed no unwillingness to abide by the arbitrators' decision." *Id.* at C17. Manuel Kaplan, moreover, filed counterclaims invoking the panel's jurisdiction. These actions, the court held, "manifest[ed] a clear acceptance of the arbitration panel's authority" to decide the question of arbitrability. *Id.* at C18. In those circumstances, the district court recognized, its power to review the arbitrators' award was "'severely limited'" (*id.* at C6): "Where a party has waived jurisdictional objections" by submitting the issue of arbitrability to the arbitration panel for decision, "the court reviews a decision to exercise jurisdiction like any other arbitration decision only for a manifest disregard of law." *Id.* at C18.

Reviewing the arbitration record, the district court then concluded that the arbitration panel's jurisdictional determination had not been in manifest disregard of law. To begin with, and "even under a *de novo* review" (Pet. App. C18),

the panel had jurisdiction over the Kaplans by the terms of the Workout Agreement:

> The Letter Agreement and the Subordinated Loan Agreement were executed in tandem, are inextricably intertwined and mutually dependent and must be read as a whole, particularly given the underlying circumstances and relationships of the parties. In view of this and the well-established federal policy favoring arbitration * * *, the court concludes that pursuant to the arbitration provision in the subordinated loan document, the arbitration panel had jurisdiction over the Kaplans.

Id. at C13-C14. In addition, it was not "completely irrational" or an "obvious" error "capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator" for the panel to have pierced the corporate veil to reach Manuel Kaplan individually. *Id.* at C27. The arbitrators, the court emphasized, "heard considerable testimony regarding the commingling of Mr. Kaplan's personal funds with those of MKI," together with "evidence that Mr. Kaplan disregarded corporate formalities and siphoned corporate funds." *Id.* at C28-C29. There was thus "ample support in the record for the arbitrators' decision to pierce the corporate veil." *Id.* at C30.

6. The Third Circuit's *De Novo* Review of the Arbitration Award

The Third Circuit reversed the order of the district court confirming the arbitration award against the Kaplans on the basis that the arbitration panel lacked jurisdiction. No deference was due the arbitrators' ruling on arbitrability, the court held, even though the Kaplans had submitted that issue to the arbitration panel for decision in the first instance. Thus, the district court should have "independently decide[d] whether [the] arbitration panel ha[d] jurisdiction over the

merits of [the] dispute." Pet. App. A14. Likewise, the court of appeals' own review of the district court's denial of the Kaplans' motion to vacate the arbitral award for lack of jurisdiction was plenary. *Id.* at A13. Having so held, the court then engaged in a lengthy *de novo* review of the evidence presented to the arbitrators, concluding that Manuel and Carol Kaplan had never waived their jurisdictional objections and had not agreed to arbitration in the Workout Agreement, and that Manuel Kaplan was not subject to Exchange jurisdiction as a member, as an "associated person," or under an alter ego theory. *Id.* at A17-A53.

SUMMARY OF ARGUMENT

A party resisting arbitration may obtain an advance judicial determination of whether the dispute is arbitrable. But that party may instead take advantage of the relative simplicity, efficiency and finality of arbitration by submitting the arbitrability question to the arbitrator. That is precisely what the respondents did in this case. In those circumstances, as the decisions of this Court, the provisions of the Federal Arbitration Act, and the holdings of several courts of appeals make clear, courts should defer to the arbitral decision on arbitrability just as they defer to arbitration decisions on the merits. The Third Circuit's approach in this case—requiring *de novo* review by the district court and once again by the court of appeals—cannot be reconciled with the provisions of the Federal Arbitration Act or with the federal policy favoring arbitration.

1. This Court has consistently recognized that absent an agreement to arbitrate, parties cannot be compelled to submit disputes to arbitration. Accordingly, parties may obtain advance judicial determinations of whether disputes are arbitrable. But they may also submit the arbitrability question to the arbitrator, and if they do so the arbitrator's

decision is entitled to the same high degree of deference as an arbitral decision on the merits.

The Federal Arbitration Act establishes the mechanics by which parties can obtain advance judicial rulings on arbitrability. Section 3 of the Act requires the courts to stay proceedings that are subject to arbitration, and section 4 permits a party to bring an action to compel arbitration. In addition, a party resisting arbitration may seek an injunction or a declaratory judgment that a dispute is not arbitrable. The parties may also submit the arbitrability issue to the arbitrator, however. If they do so, the arbitrator's decision on that issue cannot be set aside unless it was made "in manifest disregard of the law." That standard is an extraordinarily deferential one. Arbitration awards cannot be overturned on the basis of "mere error" or even "serious error"; they must be upheld unless they are "completely irrational" or so arbitrary that "a ground for the arbitrator's decision cannot be inferred from the facts of the case." See pages 21-23, *infra*.

Highly deferential review of arbitral awards on issues submitted to arbitration by the parties is essential to serve the goals of the Federal Arbitration Act: "enforcement of private agreements and encouragement of efficient and speedy dispute resolution." *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213, 221 (1985). The Third Circuit's approach encourages wasteful, strategic behavior. It permits a party to litigate the arbitrability issue (and the merits of the dispute) before the arbitrator, and then (if that party is unsuccessful) to fully relitigate the arbitrability issue in the district court and again in the court of appeals. That approach—giving the party resisting arbitration *three* bites of the apple—is contrary to the purposes of the Arbitration Act, would increase the workload of the courts, and would frustrate the intent of the parties who agreed in advance to an efficient and conclusive means of dispute resolution. It is not

at all surprising that other courts of appeals have rejected the Third Circuit's approach and have held that once the parties submit the question of arbitrability to the arbitrator, the arbitral determination of that issue is entitled to great deference.

In this case, respondents raised their jurisdictional objections at the outset. They also denied First Options' claims and asserted a $10 million counterclaim on behalf of Manuel Kaplan. Respondents subsequently withdrew their objections. Then, on the eve of arbitration nearly two years later, respondents reasserted their objections. At that point, rather than seek a judicial determination of arbitrability, respondents submitted that issue to the arbitration panel. In these circumstances, the arbitration panel's fact-bound decision denying respondents' jurisdictional challenge is entitled to deference.

2. The Third Circuit also ruled that in reviewing the district court's decision, it would "stand in the shoes" of that court and once again consider the arbitrability issue *de novo*. The court of appeals should instead have applied a deferential "abuse of discretion" standard, which the Eleventh Circuit has held best reflects the strong federal policy favoring arbitration. In the alternative, the court of appeals should at the very least have applied the usual standards of appellate review. Either standard of review should have led the court to defer to the arbitration award, because it was not made "in manifest disregard of the law."

ARGUMENT

I. WHEN PARTIES SUBMIT THE ISSUE OF ARBITRABILITY TO THE ARBITRATOR IN THE FIRST INSTANCE, THE ARBITRATOR'S DETERMINATION IS ENTITLED TO DEFERENCE

It is well-settled that ordinarily it is "for the court, not the arbitrator, to decide in the first instance whether [a] dispute [is] to be resolved through arbitration" or whether it lies outside the arbitrator's jurisdiction. *AT&T Technologies, Inc.* v. *Communications Workers of America*, 475 U.S. 643, 651 (1986). Parties to an arbitration agreement have the opportunity to obtain an advance judicial determination of whether a dispute is arbitrable, this Court has explained, because arbitration "'is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.'" *Id.* at 648. First Options does not challenge these basic principles.

This Court's precedents make equally clear, however, that "the parties [may] exclud[e] from court determination not merely the decision of the merits of [a dispute] but also the question of its arbitrability, vesting power to make both decisions in the arbitrator." *United Steelworkers* v. *Warrior & Gulf Nav. Co.*, 363 U.S. 574, 583 n.7 (1960). The text, structure, and history of the Federal Arbitration Act demonstrate, as many courts of appeals and commentators have recognized, that when the parties choose to submit the issue of jurisdiction to the arbitrator in the first instance instead of using one of the methods provided in the Act to secure an initial court ruling on that question, the arbitrator's decision as to jurisdiction is properly accorded the same deference as the arbitrator's decision on the merits.

This approach best effectuates the important federal policies favoring arbitration and freedom of contract. It promotes the efficient and economical use of arbitral and judicial

resources, allowing parties to have all issues decided by an arbitrator without diminishing their right to an advance judicial determination of arbitrability if they would rather take that course. But it does not permit a party to take repeated bites of the apple, fully litigating arbitrability before the arbitration panel and then fully relitigating that issue in the courts.

A. This Court's Precedents Establish That Parties May Submit The Issue Of Arbitral Jurisdiction To The Arbitrator, In Which Case Judicial Review Is Highly Deferential

The scope of an arbitrator's powers is defined by agreement between the parties; a party "cannot be compelled to arbitrate [a dispute] if an arbitration clause does not bind it" to do so. *John Wiley & Sons, Inc.* v. *Livingston*, 376 U.S. 543, 547 (1964). To ensure that a party is not "required to submit to arbitration any dispute which he has not agreed so to submit," this Court has recognized that a party may obtain an initial ruling from the courts on the question whether a contract provides for arbitration of the particular dispute in issue. *Warrior & Gulf Nav. Co.*, 363 U.S. at 582; see also *Atkinson* v. *Sinclair Refining Corp.*, 370 U.S. 238, 241 (1962).

While it is clear that a party cannot be *compelled* to arbitrate a dispute prior to a judicial determination that the dispute is arbitrable, there also is no doubt that parties may elect to submit the issue of arbitrability to the arbitrator in the first instance. At the core of federal laws governing arbitration, including the Federal Arbitration Act, is the principle of freedom of contract. See *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213, 220 (1985) (the Arbitration Act manifested "congressional desire to enforce agreements into which parties had entered"); *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625 (1985)

("The 'liberal federal policy favoring arbitration agreements' * * * is at bottom a policy guaranteeing the enforcement of private contractual arrangements"). Consistent with that principle, this Court has made it clear that if parties authorize the arbitrator to decide arbitrability, the courts must give effect to that decision.

Thus, in *AT&T Technologies*, a union challenging an employer's layoff decision wanted to arbitrate that dispute. After the employer refused, saying that the issue was not arbitrable, the union filed suit to compel arbitration. The lower courts held that the arbitrability issue (along with the merits of the dispute) should be submitted to the arbitrator. Reversing, this Court held that "the question of arbitrability * * * is undeniably an issue for judicial determination. *Unless the parties clearly and unmistakably provide otherwise*, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator." 475 U.S. at 649 (emphasis added). In *AT&T Technologies* there was no indication that the union had submitted the jurisdictional issue to the arbitrator. To the contrary, the union had moved the court to rule on that issue in the first instance when it sought to compel arbitration.

In this case, by contrast, respondents submitted the issue of arbitrability to the arbitrator for decision in the first instance by filing a motion to dismiss for lack of jurisdiction and a supporting memorandum with the arbitration panel. In submitting arbitrability to the arbitrator in this way, a party "clearly and unmistakably provide[s]" that arbitrability is an issue for the arbitrator rather than the court. The arbitrator's determination of the scope of arbitral jurisdiction becomes "a matter of consent, not coercion" and hence is "give[n] effect" by the court on the same terms as the other "contractual rights and expectations of the parties." *Volt Info. Sciences, Inc.* v. *Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989). Implicit in the parties'

choice is an acknowledgment that the same "efficient and speedy [system of] dispute resolution" will govern the jurisdictional issue as governs the merits (*Dean Witter Reynolds*, 470 U.S. at 221), including the same "limited role" for a court "asked to review the decision of [the] arbitrator." *United Paperworkers Int'l Union* v. *Misco, Inc.*, 484 U.S. 29, 36 (1987).

For more than a century, this Court has recognized that "[t]he law implies an agreement to abide the result of an arbitration from the fact of submission" to the arbitrator—without distinguishing between submission of the merits alone and submission, in addition, of the question of arbitrability. *Smith* v. *Morse*, 76 U.S. 76, 82 (1869). Once jurisdiction or any other contractual issue is submitted to the arbitrator, this Court has held, the arbitrator's decision on that issue will not be vacated even for serious "factual or legal error," but only for the most obvious and egregious violations of the basic rules of decisionmaking, amounting to "manifest disregard" of the law. *Misco*, 484 U.S. at 38; *Wilko* v. *Swan*, 346 U.S. 427, 436 (1953) (overruled on other grounds in *Rodriguez de Quijas* v. *Shearson/American Express, Inc.*, 490 U.S. 477 (1989)). See also R. Gorman, *Basic Text on Labor Law* 587 (1976) (The "issue of substantive arbitrability may itself be given by the parties to the arbitrator for resolution. * * * In such a case, * * * [t]he usual narrow standard of judicial review * * * should apply").

As a general matter, this Court has frequently explained that courts have an extremely limited role in reviewing arbitration decisions. "The courts are not authorized to reconsider the merits of an award even though the parties may allege that the award rests on errors of fact or on misinterpretation of the contract." *Misco*, 484 U.S. at 36. See also *AT&T Technologies*, 475 U.S. at 649-650; *United Steelworkers* v. *American Mfg. Co.*, 363 U.S. 564, 567-568 (1960).

The Third Circuit erred when it ignored these general arbitration principles in this case. Although they have been stated most frequently in labor cases, these principles are equally applicable to arbitration of other kinds of disputes under the Federal Arbitration Act. See *Misco*, 484 U.S. at 40 n.9 (noting that "the federal courts have often looked to the [Federal Arbitration] Act for guidance in labor arbitration cases"). The architecture of the Arbitration Act leaves no doubt that, contrary to the Third Circuit's ruling, judicial review of a jurisdictional issue submitted by the parties to the arbitrator is to be as narrowly circumscribed as review of the arbitrator's decision on the substance of the dispute.

B. When Parties Submit Arbitrability To The Arbitrator, The Federal Arbitration Act Requires Deferential Judicial Review Of That Issue

The Federal Arbitration Act "sets out a comprehensive plan for arbitration of controversies coming under its terms." *Commonwealth Coatings Corp.* v. *Continental Cas. Co.*, 393 U.S. 145, 146-147 (1968). The Act permits parties to obtain advance judicial determinations of arbitrability, and also permits parties to submit all of the issues in dispute—including arbitrability—to the arbitrator. Once an issue is decided through arbitration, the Act severely limits judicial review. Deference to arbitral decisions on arbitrability is every bit as essential to the proper operation of the federal arbitration scheme as deference to decisions on other issues submitted to the arbitrator.

1. The Federal Arbitration Act gives parties the option to obtain an advance judicial determination of arbitrability or to submit that issue to the arbitrator

At the heart of the Arbitration Act's "body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate" lie two sections designed to enable a party to obtain an advance judicial ruling whether a dispute is subject to arbitration. *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 25 n.32 (1983). Section 3 of the Act (9 U.S.C. § 3) provides that a party to litigation in federal court may obtain a stay of the court proceeding if the dispute is properly referable to arbitration. Section 4 requires federal courts, on the petition of a party to an agreement providing for arbitration of disputes, to compel arbitration of such a dispute. See *Prima Paints Corp.* v. *Flood & Conklin Mfg.*, 388 U.S. 395, 400 (1967) ("Section 4 provides a federal remedy for a party 'aggrieved by [failure to arbitrate]' and directs the federal court to order arbitration once it is satisfied that an agreement for arbitration has been made and has not been honored").

Congress designed these two provisions with the "clear intent * * * to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible." *Moses H. Cone Mem. Hosp.*, 460 U.S. at 22. In keeping with this goal, both sections "call for an expeditious and summary hearing, with only restricted inquiry into factual issues." *Ibid.*; see also 9 U.S.C. § 6 (providing that applications to enforce arbitration agreements are generally governed by the rules relating to motion practice); H. R. Rep. No. 96, 68th Cong., 1st Sess. 2 (1924).

The Arbitration Act thus provides a clear mechanism for a party that objects to arbitration on jurisdictional grounds to obtain a judicial ruling on arbitrability in the first instance.

"Arbitration cannot go ahead without either the resisting party's cooperation or judicial intervention," so the opportunity to defend against a section 3 or section 4 application is "all the judicial protection the resisting party needs." 2 I. MacNeil, R. Speidel, & T. Stipanowich, *Federal Arbitration Law* 23:24 (1994). In the event that the arbitration agreement provides for arbitral default awards, however, a party refusing to participate in arbitration may run the risk of default if the other party pursues arbitration without first filing an application under sections 3 or 4. It is well established that in those circumstances—and whenever a party wishes to take affirmative action to establish that an issue is not arbitrable—a party may file an independent action (or a motion in pending litigation) seeking an injunction or a declaratory judgment to prevent arbitration from going forward. *Id.* at 23:25-23:26. See, *e.g.*, *Comprehensive Accounting Corp.* v. *Rudell*, 760 F.2d 138, 139-140 (7th Cir. 1985); *George Day Constr. Co.* v. *United Bhd. of Carpenters and Joiners, Local 354*, 722 F.2d 1471, 1476 (9th Cir. 1984).[2]

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[2] The procedures set out in sections 3 and 4 of the Arbitration Act, as well as independent actions for declaratory or injunctive relief, enable parties resisting arbitration to obtain a judicial ruling on arbitrability *before* the arbitration takes place. In *George Day*, the Ninth Circuit held that a party may also be able to reserve the jurisdictional issue for court decision during post-arbitration proceedings to enforce or vacate the arbitral award "by simply not giving the arbitrability question to the arbitrator for decision," but instead expressly "reserving that question for later judicial determination." 722 F.2d at 1476. By *not* presenting the arbitrability question to the arbitrator, the court of appeals reasoned, "the question could be preserved for an independent judicial scrutiny at any subsequent proceeding for vacatur or enforcement." *Ibid.* That possibility is not raised in this case.

(continued...)

In these ways, the Arbitration Act provides ample opportunity for a party to obtain an advance judicial ruling on arbitrability. But that is not the only option: a party can forego those opportunities and instead present the arbitrability issue to the arbitrator for decision—as respondents did in this case. The choice to forego an initial judicial determination of arbitrability can be manifested by express agreement or by the act of submitting the jurisdictional dispute to the arbitrator. When parties to an arbitration agreement "argue the issue [of jurisdiction] to the arbitrator," then "[b]y their conduct" they "gran[t] the arbitrator the jurisdiction to decide their arbitrability question and 'in effect empowe[r] him to decide' those issues." *Franklin Electric Co.* v. *UAW Local 1000*, 886 F.2d 188, 192 (8th Cir. 1989); see also P. Hoblin, *Securities Arbitration* 10-9 to 10-10 (2d ed. 1992). In those circumstances, the parties have "clearly and unmistakably provide[d]" for arbitration of the arbitrability issue. *AT&T Technologies*, 475 U.S. at 649.

2. The Federal Arbitration Act requires courts to defer to arbitral decisions on issues the parties submit to the arbitrator

Once an arbitral award has been entered, a party may move the court to confirm that award (9 U.S.C. § 9), to vacate it (§ 10), or to correct or modify ministerial errors in the award. § 11. Under section 9, the court must confirm the award unless the grounds for vacation set out in section 10 are satisfied. Those grounds are very narrow: fraud in the procurement of the award (§ 10(a)(1)), serious procedural

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[2](...continued)
Far from reserving arbitrability for the court by not submitting that issue to arbitration, respondents filed a motion to dismiss and a supporting memorandum with the arbitration panel specifically requesting that it decide whether it had jurisdiction.

due process violations such as bias or improper exclusion of material evidence (§ 10(a)(2) & (3)), and "[w]here the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made." § 10(a)(4).

The standard that must be applied by a district court in reviewing an arbitrator's decision regarding issues submitted by the parties is extremely deferential. *Shearson/American Express, Inc.* v. *McMahon*, 482 U.S. 220, 232 (1987) ("judicial scrutiny of arbitration awards necessarily is limited"). That standard has been described in a number of different ways. Following *Wilko*, 346 U.S. at 436-437, most courts (including the district court in this case, Pet. App. C18) have held that an arbitrator's decision may not be vacated unless it was made in "manifest disregard of law." Courts of appeals have variously described this standard as "a sort of 'abuse of discretion' standard" (*Jenkins* v. *Prudential-Bache Sec., Inc.*, 847 F.2d 631, 634 (10th Cir. 1988)), as requiring "something beyond and different from a mere error in the law" (*Siegel* v. *Titan Indus. Corp.*, 779 F.2d 891, 892 (2d Cir. 1985)), and as applying where "the arbitrator 'understood and correctly stated the law but proceeded to ignore it.'" *Id.* at 893. Others have asked whether the arbitrator's decision was "completely irrational" (*French* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 784 F.2d 902, 906 (9th Cir. 1986)), or was "arbitrary and capricious" such that "'a ground for the arbitrator's decision cannot be inferred from the facts of the case.'" *Raiford* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 903 F.2d 1410, 1413 (11th Cir. 1990).

As the First Circuit has remarked, these different formulations—which almost invariably result in confirmation of an arbitrator's award—are essentially "identical." *Advest, Inc.* v. *McCarthy*, 914 F.2d 6, 9 (1st Cir. 1990). Unless the arbitrator's award is extraordinarily and obviously misguid-

ed—so extreme as clearly not to constitute an interpretation of the contract at all—it must be afforded deference by the district court. See *Misco*, 484 U.S. at 40 n.9 ("as long as the arbitrator is even arguably construing the contract * * *, that a court is convinced he committed serious error does not suffice to overturn his decision"); Cohen & Dayton, *The New Federal Arbitration Law*, 12 Va. L. Rev. 265, 272-273 (1926) ("The courts are bound to accept and enforce the award of the arbitrators unless there is in it a defect so inherently vicious that, as a matter of common morality, it ought not to be enforced").[3]

Any more stringent standard of review would interfere with the "statutory policy of rapid and unobstructed enforcement of arbitration agreements." *Moses H. Cone Mem. Hosp.*, 460 U.S. at 23. "[A]n extremely low standard of review" is essential if arbitration is not to become "merely

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[3] To make arbitration less costly and time-consuming and less subject to second-guessing, arbitrators commonly make their award "without explanation of their reasons" (*Wilko*, 346 U.S. at 436), as the panel did in this case when it denied respondents' motion to dismiss for lack of jurisdiction. See generally 3 I. MacNeil, R. Speidel, & T. Stipanowich, *Federal Arbitration Law* 37:15; A. Djinis & J. Post, *Securities Arbitration* § 10.02[4] (1991). Absent reasoning for an arbitral decision, a party seeking to vacate an award will be "hard pressed to satisfy the exacting criteria for invocation of the ['manifest disregard'] doctrine." *Advest*, 914 F.2d at 10; see also *A.G. Edwards & Sons* v. *McCollough*, 967 F.2d 1401, 1403 (9th Cir. 1992) ("The rule that arbitrators need not state their reasons presumes the arbitrators took a permissible route to the award where one exists"), cert. denied, 113 S. Ct. 970 (1993); C. Fletcher, *Arbitrating Securities Disputes* 387 (1990) (because "arbitrators do not normally issue opinions, it is difficult to tell whether they ignored the law"). Of course, parties are free to agree in advance that an arbitral award is to be supported by a statement of reasons.

an added preliminary step to judicial resolution rather than a true alternative." *E.I. DuPont de Nemours* v. *Grasselli Employees Indep. Ass'n*, 790 F.2d 611, 614 (7th Cir.), cert. denied, 479 U.S. 853 (1986).

Applying the correct deferential standard to the issue of arbitrability, if the parties submit that issue to arbitration in the first instance, the arbitrator's determination cannot be overturned unless it is so defective that it reflects a manifest disregard of the law. See *Wilko*, 346 U.S. at 436-437; *Ferndale Corp.* v. *Schulman Urban Dev. Assocs.*, 758 F. Supp. 861, 867-869 (S.D.N.Y. 1990) (under New York law, a party objecting to arbitral jurisdiction should make advance application to the court for a stay; if it fails to do so, its "remedy is to seek to vacate * * * the award" on the grounds set out in the statute, which parallel those listed in Federal Arbitration Act § 10 and which do not include "[t]he absence of an agreement to arbitrate"). The Third Circuit erred when, far from requiring substantial deference to the arbitrators in this case, it reviewed the question whether the arbitration panel had jurisdiction over First Options' claims against the Kaplans *de novo*. Pet. App. A14.

3. Giving effect to the parties' decision to submit the jurisdictional issue to the arbitrator best serves the goals of the Federal Arbitration Act

As we demonstrate above, the Federal Arbitration Act provides that the issue of arbitrability may be presented to the court in the first instance through section 3 and section 4 motions or independent actions for injunctive or declaratory relief. Alternatively, arbitrability may be presented to the arbitrator in the first instance, in which case the arbitrator's decisions as to jurisdiction and the merits receive the same high degree of deference when they are reviewed by the court in a proceeding brought under sections 9 or 10 of the Act. Giving deference to the arbitrator's jurisdictional

decision best reflects Congress' goals in enacting the Arbitration Act, which were "enforcement of private agreements and encouragement of efficient and speedy dispute resolution." *Dean Witter Reynolds*, 470 U.S. at 221. See, *e.g.*, *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 510-511 (1974) (the Act was designed "to place arbitration agreements 'upon the same footing as other contracts'" and "to allow parties to avoid 'the costliness and delays of litigation'").

The congressional goal of ensuring that private arbitration agreements are legally effective suggests that parties should have "the right to dispose of any controversy which may arise out of the contract in their own fashion," including the right to consent to have arbitrability decided by the arbitrator. *Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. on the Judiciary*, 68th Cong., 1st Sess. 14 (1924) (testimony of Julius Henry Cohen, a principal drafter of the Act). The parties certainly may stipulate in their formal agreement to arbitrate that matters of jurisdiction will be settled by the arbitrator. *Warrior & Gulf Nav. Co.*, 363 U.S. at 583 n.7. But courts also give effect to private arbitration agreements when they defer to a jurisdictional determination that a party *asked* the arbitrator to make.

The other principal goal of the Federal Arbitration Act—to allow parties to settle disputes by a less formal, more accelerated, and less costly method than litigation—is likewise much better served by giving full effect to the parties' decision to submit the arbitrability issue to the arbitrator. The Arbitration Act allows parties to make a trade-off, securing "prompt, economical and adequate solution of controversies though arbitration" in exchange for the procedural protections (including appellate review) and the presumed greater likelihood of "legally correct adjustment" available in the courts. *Wilko*, 346 U.S. at 438. See Ware, *Punitive Damages in Arbitration: Contracting Out of Government's Role in Punishment and Federal Preemption of*

State Law, 63 Fordham L. Rev. 529, 542 n.50 (1994) ("In agreeing to arbitrate, parties trade their substantive rights for the arbitrator's decision as constrained by the agreement and the limited judicial review of arbitral awards").

The Third Circuit's approach requires no such trade-off. Rather, it encourages a party to present its case on arbitrability and on the merits to the arbitrator, secure in the knowledge that if it loses it can reopen the arbitrability issue for *de novo* review by the court. To authorize a party to "preserv[e] for itself two bites at the apple" in this way is perversely contrary to the aim of sections 3, 4, and 10 of the Act, which is precisely to ensure that issues are fully litigated only in *one* forum. 2 I. MacNeil, R. Speidel, & T. Stipanowich, *Federal Arbitration Law* at 17:44; see also *Halley Optical Corp.* v. *Jagar Int'l Marketing Corp.*, 752 F. Supp. 638, 639-640 (S.D.N.Y. 1990) (jurisdictional objection could not be raised on motion to vacate where issue had been argued to the arbitrators; "To find otherwise would allow a party to participate in an arbitration, with the assurance that if it loses it may later challenge whether it had ever agreed to arbitration. Such a result is contrary to the clear policy favoring arbitration").

Beyond this, the Third Circuit's rule would also dramatically increase the workload of the courts. It is well understood that arbitration reduces pressure on court dockets. Indeed, that was a purpose of the Federal Arbitration Act. See, *e.g.*, *Hearing on S. 4213 and S. 4214 Before a Subcomm. of the Senate Comm. on the Judiciary*, 67th Cong., 4th Sess. 14 (1923) (the Secretary of Commerce stated that there was an "urgent need" for the Act because of "[t]he clogging of our courts"; and the ABA reported that the legislation would "reduce the congestion in the Federal and State courts"); Grossman, *The Need of Arbitration to Relieve the Congestion in the Courts*, 10 Acad. Pol. Sci. Procs. 517 (1923), reprinted in *Selected Articles on Commercial Arbitra-*

tion 33 (D. Bloomfield ed. 1927). Given the currently overloaded condition of federal dockets—and predicted increases in the workload of the federal courts over the coming decades (see Committee on Long Range Planning, Judicial Conference of the United States, *Proposed Long Range Plan for the Federal Courts* 127-129 (Nov. 1994 Draft))—the diversion of cases from litigation remains an important public benefit of the widespread use of arbitration fostered by the Act and its equivalents in the labor relations area. See *International Ass'n of Machinists & Aerospace Workers, Lodge No. 1000* v. *General Elec. Co.*, 865 F.2d 902, 904 (7th Cir. 1989). The Third Circuit's ruling that courts must consider arbitrability *de novo* although the parties have elected to present that issue to the arbitrators for decision defeats this important purpose and places an entirely unnecessary burden on courts, turning the application of sections 9 and 10 of the Act into a full-fledged inquiry into arbitral jurisdiction.

During 1990-1992 over 17,000 securities arbitrations were concluded at the major securities industry Exchanges and other Self-Regulatory Organizations. Over 63,000 arbitration claims were filed with the American Arbitration Association in 1993. National Futures Ass'n *et al. Amicus* Br. in Support of Petition for Cert. 4-6. As these statistics starkly reveal, the Third Circuit's approach could generate a substantial amount of additional litigation. Although the proportion of cases in which the question of arbitrability is submitted to the arbitrator appears to be undocumented, that proportion need not be large to impose a heavy additional burden on courts saddled with the Third Circuit's demanding standard of review. And in the labor area it is "common industrial practice to give to the arbitrator the task of deciding his own jurisdiction." R. Gorman, *Basic Text on Labor Law* at 554. *De novo* review of arbitrators' decisions on jurisdiction, despite the parties' grant of authority to the

arbitrator to decide that issue, predictably would add immensely to the resources consumed by judicial review.

"[W]hen the losing party in arbitration asks a court not to give effect to an award, it is asking that the conclusiveness which is at the heart of the process be withheld." Comment, *Judicial Deference to Arbitral Determinations: Continuing Problems of Power and Finality*, 23 U.C.L.A. L. Rev. 936, 949 (1976). There is no warrant in the text, structure, or history of the Arbitration Act to erode the conclusiveness of arbitral awards by requiring a higher standard of review for jurisdictional issues submitted to the arbitrator than for other issues—especially since the objecting party could have submitted the jurisdictional issue to the court before the arbitration took place.

C. Several Courts Of Appeals Have Held That When The Parties Submit The Issue Of Jurisdiction To Arbitration, The Arbitrator's Decision Is Entitled To Great Deference

Considering the numerous advantages of according deferential review to arbitrability determinations when the parties have submitted that issue to the arbitrator, it is not surprising that this approach has already garnered considerable support in the lower courts. The Eighth Circuit has noted a "growing consensus in the circuits * * * that the parties may impliedly consent * * * to arbitration" of the issue of jurisdiction by "arguing before the arbitrator not only the merits of a dispute, but also the question of arbitrability." *Franklin Electric Co.*, 886 F.2d at 191-192. As an earlier panel of the Third Circuit put it:

> The question of arbitrability—whether the parties contracted to arbitrate a particular grievance—is undeniably a legal issue for judicial determination. Unless the parties provide otherwise, a court, not an arbitrator, should resolve the jurisdictional issue of

> what forum should decide the merits of a claim. *If the parties submit the issue of arbitrability to the arbitrator, however, a court is obliged to give the arbitrator's decision regarding the arbitrability of a matter the same deference due an arbitrator's decision on the merits.*

United Indus. Workers v. *Virgin Islands*, 987 F.2d 162, 167 (3d Cir. 1993) (emphasis added, citations omitted).

The Sixth Circuit made the same point in *Vic Wertz Distributing Co.* v. *Teamsters Local 1038*, 898 F.2d 1136 (6th Cir. 1990):

> In the present case, the parties submitted the issue of arbitrability to the arbitrator rather than reserving the question for initial determination by the court. Agreement to have the arbitrator decide the issue of arbitrability "may be implied from the conduct of the parties in the arbitration setting." Because the parties "clearly and unmistakably" submitted the issue of arbitrability to the arbitrator without reservation, we will review the arbitrator's decision on arbitrability under the same deferential standard employed when reviewing an arbitrator's ruling on the merits.

Id. at 1140 (citation omitted). See also *Interstate Brands Corp.* v. *Chauffeurs Local Union No. 135*, 909 F.2d 885, 890 (6th Cir. 1990) (where "the parties submitted the issue of arbitrability to the arbitrator in the first instance," deference is owed to the arbitrator's ruling on that issue), cert. denied, 499 U.S. 905 (1991).

In *George Day Constr. Co.*, 722 F.2d at 1476, the Ninth Circuit similarly held that review of an arbitrator's decision on arbitrability "was narrowly circumscribed" where "the employer initially submitted the arbitrability question to the

arbitrator." The court of appeals pointed out that a party that believes the arbitrator lacks jurisdiction over a dispute has a number of ways to bring that issue to the court in the first instance. The objector "may refuse to arbitrate the case," so that the party seeking arbitration is "put to the task of petitioning the court to compel arbitration." It may expressly refuse to "giv[e] the arbitrability question to the arbitrator for decision[,] * * * reserving that question for later judicial determination." Or it may "tak[e] the initiative by seeking declaratory and injunctive relief prior to the commencement of arbitration." *Ibid.* When a party presents the arbitrability question to the arbitrator for decision instead of taking any of those steps to "obtai[n] an independent judicial examination of the question of arbitrability," it "delegate[s] that decision to the arbitrator and [the court] may not 'second-guess' him." *Id.* at 1476-1477. See also *Fortune, Alsweet & Eldridge, Inc.* v. *Daniel*, 724 F.2d 1355, 1356-1357 (9th Cir. 1983). Other courts have reached the same result.[4]

The precepts articulated in these labor cases also govern review of arbitration awards under the Federal Arbitration Act. Thus, in cases in which a party has sought to vacate an arbitrator's decision under section 10(a) of the Act, courts have applied a deferential standard of review when the parties expressly or impliedly submitted the question of jurisdiction to the arbitrator along with the merits. See *Comprehensive Accounting Corp.*, 760 F.2d at 139-141; *Amicizia Societa Navegazione* v. *Chilean Nitrate & Iodine*

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[4] See, *e.g.*, *Jones Dairy Farm* v. *Local No. P-1236*, 760 F.2d 173, 175 (7th Cir.), cert. denied, 474 U.S. 845 (1985); *Yorkaire, Inc.* v. *Sheet Metal Workers Local No. 19*, 758 F. Supp. 248, 253 (E.D. Pa. 1990); *Teamsters Local Union No. 533* v. *Herbert Fuel Oil & Trucking Co.*, 543 F. Supp. 831, 834 (S.D.N.Y. 1982).

Sales Corp., 274 F.2d 805, 809 (2d Cir.), cert. denied, 363 U.S. 843 (1960); *Halley Optical Corp.*, 752 F. Supp. at 640.

D. Because Respondents Submitted The Issue Of Arbitral Jurisdiction To The Arbitration Panel, The Arbitrators' Decision On That Question Is Entitled To Deference

As the district court found (Pet. App. C14-C18), respondents voluntarily submitted the question whether First Options' claims were arbitrable to the arbitration panel. First Options filed its Statement of Claim against MKI and against the Kaplans individually on July 1, 1989, pursuant to the arbitration rules of the Philadelphia Stock Exchange. C.A. App. A62. The Kaplans filed objections to the jurisdiction of the Exchange and its Arbitration Committee on July 24, 1989. Pet. App. A10-A11. That same day, however, the Kaplans also filed responses denying liability, which addressed the merits of First Options' claims. *Id.* at A10. In addition, Manuel Kaplan filed counterclaims against First Options seeking $10 million in damages for breach of contract, interference with prospective business opportunities, and libel and slander. *Ibid.* Later, at a pre-hearing discovery conference on February 26, 1990, the Kaplans withdrew their prior objections to the arbitrators' jurisdiction. *Id.* at C15.

Nearly two years later, on the eve of the arbitration hearing, the Kaplans changed their minds again and renewed their jurisdictional objections. The way in which they did so is of critical importance. The Kaplans did not seek declaratory or injunctive relief in district court to halt the arbitration proceeding on grounds of lack of arbitral jurisdiction. Nor did they refuse to participate in the arbitration at all, which would have given First Options the opportunity to move to compel arbitration under section 4 of the Arbitration Act. Had the Kaplans taken either of these steps, they would have

ensured that the question whether the arbitration panel had jurisdiction would come before the district court in the first instance.

Instead, the Kaplans filed a Motion to Dismiss for Lack of Jurisdiction, and a memorandum of law in support of that motion, *with the arbitration panel*. Pet. App. A11, C16; C.A. App. 194-205. In doing so, they expressly submitted the question of arbitrability for the panel's decision. Then, after the arbitrators denied their motion to dismiss (J.A. 39), the Kaplans participated in eight days of arbitration hearings on the substance of the dispute, defending against First Options' claims and pursuing Manuel Kaplan's counterclaims. The arbitrators issued an award in favor of First Options and denied the counterclaims. Pet. App. A12; J.A. 40-43.

In line with other courts that have analyzed similar circumstances (see pages 27-30, *supra*), the district court held that the Kaplans' actions "manifest[ed] a clear acceptance of the arbitration panel's authority" to determine arbitrability and that the panel's ruling on that issue was therefore to be reviewed "like any other arbitration decision only for a manifest disregard of law." Pet. App. C18. Applying that standard, the district court reviewed the documents that formed the parties' Workout Agreement. It held that because "[t]he Letter Agreement and the Subordinated Loan Agreement were executed in tandem, are inextricably intertwined and mutually dependent and must be read as a whole, particularly given the underlying circumstances and relationships of the parties," and also in light of "the well-established federal policy favoring arbitration" (*id.* at C13), the arbitration panel's determination that it had jurisdiction was not in "manifest disregard" of the law and its award should be confirmed. The court of appeals did not dispute the facts underlying the district court's decision

(many of which had been stipulated by the parties).[5] It simply concluded that "district courts should independently decide whether an arbitration panel has jurisdiction," declining to accord the arbitrators' ruling deference although the Kaplans had presented their jurisdictional objections to the panel and had then participated in arbitration of the merits of the claims and counterclaims. *Id.* at A14.

For the reasons we have already set out, the court of appeals' decision is insupportable. By failing to make use of the methods available to obtain an advance judicial ruling on arbitrability, by expressly presenting their jurisdictional objections for determination by the arbitration panel in their motion to dismiss, and by fully participating in the arbitration on the substance of the claims and counterclaims once that motion was denied, the Kaplans consented to arbitral determination of jurisdiction and waived the right to have the court rule on arbitrability in the first instance. Any other rule would significantly undermine the very benefits that the Federal Arbitration Act is designed to secure and promote, thwarting the speed and finality of consensual arbitration and wasting the resources of the federal courts, arbitrators, and parties alike.

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[5] In the district court, the parties stipulated that (1) the Kaplans filed responses to First Options' claims "denying liability" (J.A. 54, ¶ 3); (2) "Mr. Kaplan filed counterclaims against First Options * * * seeking $10,000,000 * * * for breach of contract, interference with prospective business opportunity and libel and slander" (*ibid.*); (3) the Kaplans withdrew their "jurisdiction objections from consideration at the February 26, 1990 discovery conference" and "thereafter participated without objection in th[at] pre-hearing conference" (*id.* at 55, ¶ 5); and (4) "[o]n January 6, 1992, the Kaplans filed a motion and supporting memorandum seeking the dismissal of the claims against them for lack of jurisdiction," which "[t]he arbitration panel denied." *Id.* at 55, ¶¶ 11-12.

II. IN REVIEWING THE DISTRICT COURT'S CONFIRMATION OF THE ARBITRATION AWARD IN THIS CASE, THE COURT OF APPEALS SHOULD NOT HAVE REEXAMINED THE ARBITRABILITY ISSUE *DE NOVO*

In reviewing the district court's denial of the Kaplans' motion to vacate the arbitration award, the Third Circuit (Pet. App. A13) applied the *de novo* standard it previously articulated in *Mutual Fire, Marine & Inland Ins. Co.* v. *Norad Reinsurance Co.*, 868 F.2d 52, 56 (3d Cir. 1989):

> In reviewing the district court's denial of appellant's motion to vacate the arbitration award, this Court will stand in the shoes of the district court and determine whether appellants were entitled to vacate the arbitration award pursuant to 9 U.S.C. § 10(d).

See also *Colonial Penn Ins. Co.* v. *Omaha Indem. Co.*, 943 F.2d 327, 331 (3d Cir. 1991).

The court of appeals' *de novo* review of the district court's decision is particularly troublesome because it is coupled with its ruling that district courts should review arbitral jurisdiction decisions *de novo*. The Third Circuit's rule thus gives parties *three* opportunities to litigate arbitrability *de novo*: once before the arbitration panel, a second time before the district court, and yet a third time before the court of appeals. It is hard to conceive of a set of rules more hostile to the fundamental principle that courts should defer to arbitral decisions on issues the parties submit to the arbitrator, or one more wasteful of appellate resources.

This Court should reject the Third Circuit's approach and either adopt the bifurcated standard of review used by the Eleventh Circuit, or hold that the ordinary standards of appellate review should be applied. Under either alternative,

the Third Circuit's decision vacating the arbitration award in this case cannot stand.

A. As The Eleventh Circuit Has Held, Courts Of Appeals Should Apply A Deferential Standard When Reviewing District Court Decisions Confirming Or Refusing To Vacate Arbitration Awards

The Eleventh Circuit has adopted a hybrid standard of appellate review that is very different from the standard applied by the Third Circuit in this case. The Eleventh Circuit examines a district court's *confirmation* of an arbitration award using a deferential "abuse of discretion" standard, but reviews *vacation* of an award *de novo*. *Robbins* v. *Day*, 954 F.2d 679, 681-682 (11th Cir.), cert. denied, 113 S. Ct. 201 (1992). "By broadly reviewing the grant of a motion to vacate an arbitration award, while narrowly reviewing confirmation of an award, we emphasize the unique context of arbitration, which requires deferential judicial review to promote the primary advantages of arbitration—speed and finality." *Id.* at 682; see also 4 I. MacNeil, R. Speidel, & T. Stipanowich, *Federal Arbitration Law* at 43:62-43:65 & 1994 Supp. at 43:12-43:13; Kupperman & Freeman, *Selected Topics in Securities Arbitration*, 65 Tul. L. Rev. 1547, 1605 (1991).

The Eleventh Circuit's approach properly reflects federal arbitration policy and derives considerable support from the structure of the Arbitration Act:

> The standard most likely to reflect the strong federal policy favoring arbitration is a hybrid standard—one that requires an appellate court to review confirmation of an award for an abuse of discretion and to review vacation of an award de novo. Such a standard would * * * require rigorous review of rulings vacating awards but only limited review of rulings confirming awards. It would also mirror the structure of section 15 [now renumbered section 16] of the Arbitration Act. Section 15 permits interlocutory appeals of orders favoring litigation over arbitration but not vice-versa. More specifically, it permits interlocutory appeals of orders denying motions to compel arbitration and motions to stay litigation pending arbitration but forbids interlocutory appeals of orders granting motions to compel and motions to stay.

Kupperman & Freeman, *supra*, 65 Tul. L. Rev. at 1605.

Section 10 of the Arbitration Act makes clear that arbitration is not intended as the first step of a three-step adjudicative process. Instead, it is intended to resolve disputes finally and conclusively, with little or no court intervention. The Eleventh Circuit's appellate review standard carries out this important federal policy. By "reversing a district court's denial of a motion to vacate an arbitration only upon abuse of discretion, [the court of appeals] further[s] the presumption that the arbitration proceeding was proper." 954 F.2d at 682.

In applying the Eleventh Circuit's standard, courts of appeals reviewing decisions confirming or refusing to vacate arbitration awards should ascertain whether the district court properly articulated the deferential standard of review. If the district court invoked the correct standard, its decision should not be overturned unless it clearly "misapprehended or grossly misapplied" that standard. *Cf. FTC* v. *Indiana Federation of Dentists*, 476 U.S. 447, 453 (1986) (considering whether court of appeals "misapprehended or grossly misapplied" the substantial evidence test); *Anderson* v. *Bessemer City*, 470 U.S. 546, 566 (1985) (examining whether a court of appeals misapprehended and misapplied the clearly erroneous standard). Any more searching

appellate review would be destructive of the parties' selection of arbitration as an expeditious and conclusive means to resolve disputes.

On the other hand, if the district court vacates or refuses to confirm the arbitration award, on appeal deference continues to be due to arbitration—the process selected by the parties—and not to the district court. *Labor Relations Div.* v. *International Bhd. of Teamsters*, 29 F.3d 742, 745 (1st Cir. 1994). In that circumstance, the court of appeals *should* "stand in the shoes of the district court" and thus should apply the same deferential standard the district court should have applied.

B. Under Ordinary Standards Of Appellate Review, The Court Of Appeals Should Have Upheld The District Court's Ruling

Although we urge this Court to adopt the Eleventh Circuit's framework, in this case the same result (confirmation of the arbitrators' award) should have been reached had the court of appeals properly applied the usual standards of appellate review applicable to nonjury civil cases. Under those standards, a district court's factual findings cannot be disturbed unless they are clearly erroneous; mixed questions of law and fact are also ordinarily entitled to "deferential review"; and conclusions of law are subject to "independent review." *Salve Regina College* v. *Russell*, 499 U.S. 225, 232-233 (1991).

The district court's confirmation of the arbitration panel's jurisdictional holding was largely based on the particular facts of this case, and was therefore entitled to deferential review. As the district court pointed out (Pet. App. C13), interpretation of the ambiguous four-part Workout Agreement (including the Letter Agreement signed by the Kaplans and the Subordinated Loan Agreement that expressly made disputes "relating to * * * the Letter Agreement" subject to

arbitration) depended in part upon facts about "the underlying circumstances and relationships of the parties." It has long been understood that "where the effect of a written instrument depends * * * upon extrinsic facts and circumstances," its meaning is a question "of fact and not of law" and is therefore subject to deferential review. *West* v. *Smith*, 101 U.S. 263, 270 (1879); see also 1 S. Childress & M. Davis, *Federal Standards of Review* 2-168 (2d ed. 1992) ("The clearly erroneous rule generally applies to a finding regarding the intent of the contracting parties").

Other factual issues also played a role in the arbitration panel's decision that it had jurisdiction, including the questions whether the Kaplans intended to waive their jurisdictional objections when they withdrew those objections and participated in a discovery conference which was an integral part of the arbitration proceedings (Pet. App. C15), whether Manuel Kaplan commingled personal funds with those of MKI (*id.* at C28), whether Kaplan "disregarded corporate formalities and siphoned corporate funds" (*id.* at C29) and whether the factual predicates existed to pierce MKI's corporate veil so as to subject Manuel Kaplan to the arbitrators' jurisdiction through MKI's undisputed consent to arbitration. *Id.* at C27-C30. The district court's conclusion that there was "ample support in the record for the arbitrator's decision to pierce the corporate veil" (*id.* at C30) confirmed a factual finding that was not only central to the arbitration panel's resolution of the merits of the dispute, but that was also one of the bases for arbitral jurisdiction asserted by First Options.

The district court's fact-bound conclusion that the arbitrators' jurisdictional decision was not "in manifest disregard of the law" should not have been subjected to *de novo* review, but instead should have been upheld under the clearly erroneous standard. As this Court has observed, a district court's factual analysis is entitled to deference even

when it is based solely on "documentary evidence or inferences from other facts" (*Anderson*, 470 U.S. at 574), rather than on observation of witnesses or on credibility determinations:

> The rationale for deference to the original finder of fact is not limited to the superiority of the trial judge's position to make determinations of credibility. The trial judge's major role is determination of fact, and with experience in fulfilling that role comes expertise. Duplication of the trial judge's efforts in the court of appeals would very likely contribute only negligibly to the accuracy of fact determinations at a huge cost in diversion of judicial resources.

Id. at 574-575. Surely in this case, even more than in most other cases, duplication of the district court's efforts—and thus *triplication* of the arbitrators' efforts—would "contribute only negligibly [if at all] to the accuracy of fact determination at a large cost in diversion of judicial resources" and in frustration of the selection of arbitration as the exclusive means of dispute resolution.

The district court's review of arbitral jurisdiction was based largely on fact and was thus entitled to deference. But even assuming that the district court's confirmation of the arbitration decision could be regarded as a conclusion of law, proper "independent review" by the court of appeals should have led the court to apply the same "manifest disregard" standard that governs a district court's review of an arbitrator's award. See Cohen & Dayton, *supra*, 12 Va. L. Rev. at 273 (statement by a principal draftsman of the Act that appeals would not "restor[e] the technicality and delay of legal procedure" because "the grounds of the appeal are necessarily limited to those allowed for vacating, modifying, or correcting an award. This by itself removed the vast

majority of questions with which appeals are usually concerned").

Rather than independently applying the manifest disregard standard, the Third Circuit improperly substituted its judgment for those of both the district court and the arbitration panel, and reviewed *de novo* all of the factual bases for the arbitration panel's decision and the district court's confirmation of the arbitral award. Pet. App. A15-A52. Independent review does not license the court of appeals to substitute its judgment for that of the arbitrators. If respect for freedom of contract and for the parties' choice of arbitration requires district courts to defer to arbitration decisions, the same policies cannot permit appellate courts to review arbitral awards *de novo*.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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STATUTORY APPENDIX

1. The Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, provides in pertinent part:

> § 3. Stay of proceedings where issue therein referable to arbitration
>
> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.
>
> § 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination
>
> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making

of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect or refusal to perform same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

* * *

§ 6. Application heard as motion

Any application to the court hereunder shall be made and heard in the manner provided by law for the making and hearing of motions, except as otherwise herein expressly provided.

* * *

§ 9. Award of arbitrators; confirmation; jurisdiction; procedure

If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title. If no court is specified in the agreement of the parties, then such application may be made to the United States court in and for the district within which such award was made. Notice of the application shall be served upon the adverse party, and thereupon the court shall have jurisdiction of such party as though he had appeared generally in the proceeding. * * *.

§ 10. Same; vacation; grounds; rehearing

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

(1) Where the award was procured by corruption, fraud, or undue means.

(2) Where there was evident partiality or corruption in the arbitrators, or either of them.

(3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

(5) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators.

* * *

§ 11. Same; modification or correction; grounds; order

In either of the following cases the United States court in and for the district wherein the award was made may make an order modifying or correcting the award upon the application of any party to the arbitration—

(a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.

(b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.

(c) Where the award is imperfect in matter of form not affecting the merits of the controversy.

The order may modify and correct the award, so as to affect the intent thereof and promote justice between the parties.

* * *

§16. Appeals

(a) An appeal may be taken from—

(1) an order—

(A) refusing a stay of any action under section 3 of this title,

(B) denying a petition under section 4 of this title to order arbitration to proceed,

(C) denying an application under section 206 of this title to compel arbitration,

(D) confirming or denying confirmation of an award or partial award, or

(E) modifying, correcting, or vacating an award;

(2) an interlocutory order granting, continuing, or modifying an injunction against an arbitration that is subject to this title; or

(3) a final decision with respect to arbitration that is subject to this title.

(b) Except as otherwise provided in section 1292(b) of title 28, an appeal may not be taken from an interlocutory order—

(1) granting a stay of any action under section 3 of this title;

(2) directing arbitration to proceed under section 4 of this title;

(3) compelling arbitration under section 206 of this title; or

(4) refusing to enjoin an arbitration that is subject to this title.

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QUESTIONS PRESENTED

1. Where the parties did not clearly and unmistakably agree that the question of arbitral jurisdiction was for the arbitrators and not for the courts, did the court of appeals properly review *de novo* the arbitrators' assertion of jurisdiction over the controversy?

2. Did the court of appeals properly apply ordinary appellate review to the district court's refusal to vacate the arbitration award, rather than altering the standard of appellate review based on the outcome of the district court proceedings?

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

No. 94-560

FIRST OPTIONS OF CHICAGO, INC.,
Petitioner,

v.

MANUEL KAPLAN, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF FOR RESPONDENT MANUEL KAPLAN

STATEMENT OF THE CASE

From 1984 until January 1989, respondent M.K. Investments, Inc. ("MKI") was an options market maker on the Philadelphia Stock Exchange ("the Exchange"). Petitioner First Options of Chicago, Inc. ("First Options") is the largest clearinghouse at the Exchange and functioned as MKI's clearinghouse until January 1989, when First Options took over MKI's trading account and put MKI out of business.[1] At the time of the arbitration underlying this case, Mr. Kaplan and MKI had been out

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[1] An options market maker trades options for its own account. A clearinghouse facilitates a market maker's trading by providing administrative support and risk control services and by guaranteeing a market maker's account to other traders. A clearinghouse is compensated by, *inter alia*, commissions generated by the market maker.

of business and off the Exchange for three years. Pet. App. A4, A9; Joint Appendix ("J.A.") 65.

Respondent Manuel Kaplan was the president and, from 1986 on, the sole shareholder of MKI. Respondent Carol Kaplan is Manuel Kaplan's wife. She has never had any ownership interest in MKI, nor did she have any dealings or affiliation with First Options or the Exchange. Pet. App. A5; J.A. 65. MKI itself is only a nominal respondent here. The court of appeals affirmed the district court's judgment with respect to MKI, and MKI did not seek further review. Accordingly, as the case comes to this Court, it concerns only Petitioner's efforts to arbitrate its claims against Mr. and Mrs. Kaplan. As explained in further detail below, Petitioner has persisted in this effort despite the fact that neither Mr. Kaplan nor Mrs. Kaplan ever entered into any agreement to arbitrate with First Options.

In an apparent effort to skew the Court's view of the legal issues presented here, Petitioner sets forth a distorted version of the facts. Many of Petitioner's assertions are not supported by the record and are in any event irrelevant to the questions on which the Court has granted review. In the paragraphs that follow, we do not attempt to address all of the unfounded accusations in Petitioner's brief, but instead focus on the facts relevant to the issues before the Court.

A. The Crash, the Workout, and the Release

In October, 1987, as a result of the largest percentage drop in stock exchange history ("the Crash"), MKI's trading account lost a $10 million positive balance almost overnight. The net equity in the MKI trading account went from $10.5 million on October 14, 1987 to *negative* $2.1 million on October 19, 1987. Pet. App. A5.

After the Crash, First Options took control of the MKI account and liquidated all of MKI's positions. In the course of that liquidation, First Options *decreased* the

value of the MKI account to negative $5.1 million. Pet. App. A5-A6.

MKI and First Options almost immediately entered into settlement negotiations concerning MKI's negative balance. Under the 1984 Market-Maker Agreement that governed MKI's relationship with First Options, *see* Pet. App. A4-A5, MKI was liable to First Options for any deficit balance in its accounts, but MKI's principals did not assume any personal liability. First Options nevertheless sought to hold Mr. Kaplan personally liable for the entire $5.1 million. Mr. Kaplan and MKI contested the amount of the debt, contending that First Options had increased the debt by mishandling the account in liquidation. Pet. App. A6.

In late 1987, the parties reached a "handshake deal," agreeing on the general terms of a workout. Pet. App. A6. Over the next four months, the parties negotiated the details of a four-contract, 28-page settlement/workout agreement, spelling out all the rights and liabilities of the parties. Pet. App. A6-A8; J.A. 4-38.[2] First Options was represented in the workout negotiations primarily by its Philadelphia branch manager and several in-house attorneys for Continental Illinois Bank, First Options' parent at the time. R. 710.[3] MKI was represented by Mr. Kaplan, and by its and his attorney, Steve Wallenstein. R. 815.[4]

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[2] That settlement completely resolved all prior differences among the parties, rendering any pre-workout disputes irrelevant. Pet. App. A6; J.A. 19-20.

[3] "R." refers to the four-volume appendix to respondents' brief in the court of appeals.

[4] Petitioner misrepresents the circumstances surrounding Mr. Kaplan's withdrawal of funds following the Crash (a withdrawal unrelated to the issues before this Court). Petitioner claims that "[i]nstead of using this cash to repay MKI's creditors, Mr. Kaplan withdrew $611,300 between October 19 and December 18, 1987." Pet. Br. at 3. In a proceeding brought by First Options to deter-

Because certain aspects of the workout were applicable only to certain parties, the agreement consisted of four separate contracts, each signed by different parties. Only one of the four contracts (the Subordinated Loan Agreement) contained an arbitration clause, and that contract was signed only by First Options and MKI—*not* by Manuel or Carol Kaplan. J.A. 30-36, 57; Pet. App. A6-A7. Manuel and Carol Kaplan signed only one of the four contracts (the Letter Agreement), and that contract *did not contain an arbitration provision.* J.A. 4-23, 57; Pet. App. A7.[5]

The salient points of the settlement, signed March 24, 1988, were as follows:

- The corporation MKI agreed to repay the full amount of the Crash debt, including the $3 million created by First Options' trading of the account. J.A. 4.

---

mine the dischargeability of Mr. Kaplan's judgment debt, however, the United States Bankruptcy Court for the Eastern District of Pennsylvania found, on the basis of uncontroverted testimony, that the withdrawn funds *were* used to repay MKI's creditors. *In re Kaplan*, 162 B.R. 684, 702 (Bankr. E.D. Pa. 1993).

[5] Contrary to Petitioner's contention, Pet. Br. at 3, the arbitration clause in the Subordinated Loan Agreement did not "on its face appl[y] to the Letter Agreement." It merely provided that the parties to the Subordinated Loan Agreement—*i.e.*, First Options and MKI—would arbitrate any disputes arising out of the Letter Agreement. J.A. 34-35.

Moreover, Paragraph 12 of the Letter Agreement specifically provided that the signature of Mrs. Kaplan—who received no consideration under the workout—had only the limited effect of evidencing her agreement to cooperate in remitting the joint tax refund: "Mrs. Kaplan is signing this agreement to evidence her agreement to sign all documents necessary to fulfill the terms of this agreement applicable to her," *i.e.*, remittance of the 1987 joint tax refund. J.A. 20. Mrs. Kaplan did not "agree[] on the terms of a workout," Pet. Br. at 3. She agreed only to remit a refund check.

- MKI immediately transferred more than $500,000 in Exchange memberships to First Options. J.A. 6.
- MKI and Mr. Kaplan immediately contributed $900,000 to fund a new trading account—

  $400,000 from MKI's interest in a specialist account; and

  $500,000 from Mr. Kaplan's personal funds. J.A. 7-8; R. 1234.
- Mr. Kaplan immediately paid First Options $80,000. J.A. 6; R. 1234, 1383.
- Mr. Kaplan (and Mrs. Kaplan) agreed to remit to First Options their 1987 joint tax refund, estimated to be $300,000, upon receipt. J.A. 7.
- MKI agreed to split its future trading profits with First Options. J.A. 10-13.

First Options also agreed to release the corporation (MKI) and Mr. Kaplan (individually). However, because the debt belonged to the corporation and not to Mr. Kaplan, the releases differed in one critical respect:

- First Options released MKI from any claims First Options might have against MKI for the disputed debt, *upon performance of MKI's obligations under the Agreement (i.e., payment in full of the debt).* J.A. 19.
- First Options *unconditionally* released Mr. Kaplan from any claims First Options might have against him personally for the disputed debt. J.A. 20.

Mr. Kaplan did not personally guarantee MKI's debt under the workout. J.A. 4-5, 30.

B. The Dispute

Pursuant to the workout agreement, MKI resumed trading in April, 1988. On January 17, 1989, Barry Seidman (First Options' CEO) and Mr. Kaplan engaged in a "heated exchange" on a conference call, R. 726,

and Mr. Seidman ordered Mr. Kaplan to leave the office. R. 687-88, 875.[6] First Options thereafter ordered all MKI traders off the trading floor, shut off MKI's phones, changed the locks on MKI's office, and barred Mr. Kaplan from MKI's premises. R. 876. Neither Mr. Kaplan nor MKI has been able to trade options since. R. 1114, 1323.

Soon after ousting Mr. Kaplan from his business, First Options demanded: (i) that Mr. and Mrs. Kaplan turn over their 1987 joint tax refund and (ii) that MKI open its books and records for inspection. R. 249-52. Because they believed (and still believe) that First Options had destroyed MKI's business without justification, the Kaplans did not comply. First Options declared an event of acceleration under the workout and demanded immediate repayment *by MKI* of the full workout debt. R. 252.

On June 21, 1989, First Options filed for arbitration, seeking an award against Manuel and Carol Kaplan for the amount of the 1987 joint tax refund, and contending, based on a piercing-the-corporate-veil theory, that Manuel Kaplan—as well as MKI—was liable for the full workout debt of the corporation. R. 62-71; J.A. 54.

C. The Arbitration

MKI and First Options (but not Manuel or Carol Kaplan) signed a Submission Agreement presenting their dispute to the Exchange for arbitration. J.A. 54. By contrast, Manuel and Carol Kaplan "refused to sign any submission form," Pet. App. A18, and formally objected to Exchange jurisdiction. J.A. 54-55; R. 172, 175.

On February 26, 1990, the Exchange conducted a pre-hearing discovery conference. The parties stipulated as follows regarding the events at that conference:

[6] The substance of that phone call and the reasons for First Options' banishment of Mr. Kaplan remain vigorously disputed by the parties, but are irrelevant to the issues before this Court.

> 5. The Kaplans' then-counsel Thomas Zielinski withdrew the Kaplans' jurisdiction objections *from consideration at the February 26, 1990 discovery conference*. The Kaplans thereafter participated without objection in the pre-hearing conference on February 26, 1990.
>
> 6. The February 26, 1990 discovery order made no mention of the jurisdictional issue.

J.A. 55 (emphasis added). The Kaplans' former counsel set aside the Kaplans' jurisdictional objections from consideration at the discovery conference only in order to participate in that conference. This temporary and limited withdrawal did not waive the objections. As the court of appeals held:

> The Kaplans did not waive their objections. They reasserted them regularly during the arbitration proceeding. Repeated objection was not required while the case lay dormant. Their participation in the 1990 discovery conference did not waive their objections to the arbitrators' jurisdiction. We cannot say that this act "clearly indicated [their] willingness to forego judicial review."

Pet. App. A21 (quoting *Pennsylvania Power Co. v. Local Union No. 272*, 886 F.2d 46, 50 (3d Cir. 1989)).[7]

Following the February 26, 1990 discovery conference, the case lay dormant for 22 months—no discovery took place, no motions were filed, and no rulings were issued. Pet. App. A11; J.A. 55. In December, 1991, new counsel took over the case for the Kaplans. J.A. 55. On January 6, 1992, Mr. and Mrs. Kaplan filed a motion to dismiss for lack of jurisdiction. In their supporting memorandum, the Kaplans stated that they were "reiterat[ing] and re-

[7] The February 26, 1990 discovery order was subsequently vacated. J.A. 58. Thus, the February 26, 1990 discovery conference—the basis on which First Options alleged that the Kaplans had waived their jurisdictional objections—had no substantive impact on the arbitration proceeding.

new[ing] their objections to the [Arbitration] Committee's jurisdiction." On January 14, 1992, the Exchange denied the motion to dismiss without explanation. J.A. 39, 55.[8]

On June 5, 1992, the Exchange Arbitration Panel issued its decision in favor of First Options and against the Kaplans. By a vote of 5 to 2, the Panel:

- entered an award against MKI in the amount of $5,662,188, plus interest;
- held Manuel Kaplan jointly and severally liable for the MKI debt (piercing the MKI corporate veil);
- entered an award against Manuel Kaplan in the amount of the 1987 joint tax refund ($346,342), plus interest;
- held Carol Kaplan jointly and severally liable for the 1987 joint tax refund, plus interest; and
- denied Manuel Kaplan's and MKI's counterclaims based on First Options' destruction of the MKI business in January, 1989. J.A. 40-43, 64.

Respondents filed a timely petition to vacate the arbitral award, and Petitioner filed a cross-petition to confirm the award. In the district court, the parties stipulated to virtually all the relevant facts. *See* J.A. 54-67; Pet. App. C1-C2.

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[8] The Order on the motion to dismiss makes no mention of any waiver and gives no indication that it was decided other than on the merits. J.A. 39. Indeed, the Order states that the motion was denied "after full consideration." *Id.* Moreover, in a telephone conversation after the Exchange's ruling, the Director of Arbitration informed the Kaplans' counsel that the ruling was consistent with the Exchange's standing interpretation of arbitral jurisdiction. She did not mention any withdrawal or waiver of the Kaplans' jurisdictional objections. J.A. 52.

D. The District Court Ruling

In an unpublished memorandum and order entered September 25, 1992, the district court confirmed the arbitration award. Pet. App. C1-C35. The court held that Manuel and Carol Kaplan had consented to Exchange arbitration through the arbitration provision in the Subordinated Loan Agreement, even though neither Manuel nor Carol Kaplan had signed that Agreement. *Id.* at C10-C14. Alternatively, the court held that the Kaplans, by their former counsel, had waived their jurisdictional objections. Id. at C14.[9]

Respondents appealed the district court's decision. On February 2, 1993, Mr. Kaplan filed a petition for relief under the Bankruptcy Code (Bankr. E.D. Pa. No. 93-10625S). On March 10, 1993, the bankruptcy court modified the automatic stay to permit Mr. Kaplan's appeal to proceed.

E. The Court of Appeals Ruling

On March 31, 1994, the Court of Appeals for the Third Circuit affirmed the district court's judgment as to MKI,[10] but reversed as to Manuel and Carol Kaplan, holding that the arbitrators lacked jurisdiction over the Kaplans. Pet. App. A3-A4.

In its unanimous opinion, the court of appeals held:

- that it would review *de novo* the district court's denial of Respondents' petition to vacate the arbitration award, Pet. App. A13;

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[9] The court also affirmed the Exchange's decision to pierce the corporate veil, holding that Mr. Kaplan's release was conditional upon performance of the workout agreement, and therefore void because Mr. Kaplan had not fully performed. Pet. App. C30. Without explanation, the court held, in the alternative, that the veil was properly pierced even if Mr. Kaplan's release was unconditional. *Id.*

[10] MKI did not file a cross-petition for certiorari in this Court; therefore, the judgment against MKI is not at issue here.

- that the Kaplans had not waived their jurisdictional objections, Pet. App. A17-A21;
- that because arbitrability is a question for the court to decide, the arbitrators' assertion of jurisdiction over the Kaplans was not entitled to deference, Pet. App. A22-A23;
- that the arbitrators lacked jurisdiction over the Kaplans, Pet. App. A3-A4; [11] and
- that the evidence was insufficient to allow the piercing of MKI's corporate veil to impose $5,662,188 in personal liability upon Mr. Kaplan, Pet. App. A52.[12]

On June 29, 1994, the court of appeals denied First Options' Petition for Rehearing with Suggestion for Rehearing In Banc. Pet. App. B1-B2. First Options filed a petition for certiorari, which this Court granted on December 5, 1994. The grant was limited to the first two questions presented by the petition.

SUMMARY OF ARGUMENT

A party cannot be forced to arbitrate a dispute it has not agreed to arbitrate, and accordingly arbitrability is ordinarily an issue for courts, rather than arbitrators. As this Court has held, "[u]nless the parties *clearly and unmistakably provide* otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator." *AT&T Technologies, Inc. v. Communications Workers,* 475 U.S. 643, 649 (1986) (emphasis added). This is particularly true where, as here, the issue is not whether a particular dispute falls within an acknowledged agreement of the parties to arbitrate, but instead whether there is any such agreement at all.

[11] After the court of appeals held that the arbitrators lacked jurisdiction over the Kaplans, Petitioner filed actions raising the same claims against Manuel Kaplan in the United States Bankruptcy Court for the Eastern District of Pennsylvania (Bankr. E.D. Pa. No. 94-0901) and against Carol Kaplan in the United States District Court for the Eastern District of Pennsylvania (E.D. Pa. No. 94-5941).

[12] The court of appeals did not address the "alter ego" issue on the merits, but as a proffered basis for arbitral jurisdiction over Mr. Kaplan. Pet. App. A43-A44, A52 n.29. Because it found no basis for arbitral jurisdiction over the Kaplans, the court of appeals did not reach and specifically reserved the issue of whether Mr. Kaplan had been unconditionally released from any pre-workout obligations to Petitioner. Pet. App. A30 n.16.

Petitioner cannot, and does not, deny this basic proposition. What Petitioner does, however, is propose that parties who wish to preserve the right recognized by this Court in *AT&T Technologies*—the right to an independent judicial determination of arbitrability—must undertake extraordinary procedural steps, steps that increase rather than minimize judicial intrusion into the arbitration process. According to Petitioner, such a party must immediately go to court and secure declaratory and injunctive relief blocking the arbitration, or, alternatively, must somehow otherwise prevent the arbitration from going forward and force the party seeking arbitration to go to court to obtain an order compelling it. Otherwise, according to Petitioner, an arbitrator's decision on his or her own jurisdiction bars the objecting party from *de novo* judicial consideration of the issue.

This is not, and should not be, the law. Contrary to Petitioner's suggestions, nothing in the Federal Arbitration Act ("the Act") remotely imposes such procedural requirements. Indeed, the Act fails even to provide a mechanism for seeking stays of arbitration. If seeking such a stay were intended to be a prerequisite for a party objecting to jurisdiction to obtain the independent court determination of arbitrability that is its conceded right, the drafters of the Act certainly would have addressed the question in the statute. Instead, the language and structure of the Federal Arbitration Act strongly support the proposition that courts should independently review con-

tested arbitral assertions of jurisdiction. The Act specifically provides for vacatur of arbitral awards where arbitrators "exceeded their powers," 9 U.S.C. § 10(a)(4), and nowhere indicates that courts should defer to arbitrators in applying this provision.

Given that the Federal Arbitration Act does not mandate Petitioner's approach, the question is whether this Court should impose it as a matter of policy. Contrary to Petitioner's assertion, the holding below does not pose any unfairness to the party initiating arbitration. Independent judicial review of arbitrators' jurisdictional decisions simply places the parties on an equal footing. The same approach applies to court of appeals review of questions of a district court's jurisdiction, and that has never been thought unfair to the party invoking the district court's jurisdiction. Several other courts of appeals in addition to the Third Circuit have accordingly held that where, as here, a party refuses to sign a submission agreement and unsuccessfully argues jurisdictional objections before an arbitrator, the courts should review the arbitrator's jurisdictional decision *de novo*.

The federal policies favoring enforcement of private arbitration agreements, efficient resolution of disputes, and judicial economy all support a rule that allows a party to argue jurisdictional objections to an arbitrator without waiving its rights to *de novo* judicial review of arbitrability. Under Petitioner's approach, the federal courts would necessarily become involved at the outset of *every* controversy in which there was a dispute as to arbitrability, and the objecting party desired to preserve its right to an independent judicial determination of that issue. That is because the objecting party either would have to resort to court to obtain a declaratory judgment and injunction blocking arbitration, or would have to stonewall any arbitration and force its adversary to resort to court for an order compelling arbitration. Under the approach reaffirmed by the Third Circuit, however, judicial involvement in arbitration is kept to a minimum. An

arbitrator's decision either on the jurisdictional issue or on the merits may remove the necessity for courts to consider the claims of the objecting party at all.

Neither Manuel nor Carol Kaplan signed any agreement to arbitrate any dispute with First Options. Indeed, as the court of appeals recognized, the circumstances of this case and the workout agreement from which the instant dispute arises plainly and unambiguously demonstrate the absence of an agreement to arbitrate by the Kaplans. The Kaplans did everything required under applicable law to preserve their jurisdictional objections for independent judicial review. It would be manifestly unfair to deny them such review under the circumstances of this case.

Moreover, even if this Court were to hold that the arbitrators' assertion of jurisdiction should have been reviewed with deference, the court of appeals' reversal of the arbitrators' assertion of jurisdiction over the Kaplans should be affirmed. Because the arbitrators ignored the plain, unambiguous language of the parties' agreement in forcing the Kaplans to arbitrate their dispute under the workout agreement with First Options, the arbitrators' assertion of jurisdiction over the Kaplans cannot survive even deferential review.

Finally, this Court should reject Petitioner's suggested "hybrid" or "bifurcated" standard for appellate review of district court decisions to confirm or vacate arbitral awards. Such a standard is contrary to the law of at least nine circuits, is blatantly result-oriented, and would skew the institutional relationship between the district courts and the courts of appeals.

In the instant case, the Court of Appeals for the Third Circuit properly applied ordinary appellate review, deferring to the district court's findings of fact and reviewing its legal conclusions *de novo*. Because the court of appeals reached the correct conclusion under the appropriate standard, its judgment should be affirmed.

ARGUMENT

I. THE COURT OF APPEALS CORRECTLY CONCLUDED THAT THE KAPLANS WERE ENTITLED TO INDEPENDENT JUDICIAL CONSIDERATION OF THEIR OBJECTIONS TO ARBITRAL JURISDICTION.

Petitioner concedes that whether a party has agreed to arbitrate is an issue that ordinarily merits independent judicial determination. *See* Pet. Br. at 13. However, it contends that in the instant case, the Kaplans failed to take the procedural steps necessary to obtain such a determination.

Petitioner suggests three methods by which the Kaplans could have obtained independent judicial consideration of their objections to arbitral jurisdiction. The alternative Petitioner emphasizes most heavily is that the Kaplans could have run immediately into federal court to seek declaratory and injunctive relief blocking arbitration. *See* Pet. Br. at 19, 30. Second, Petitioner suggests that the Kaplans could have refused to participate in any arbitral proceedings at all, forcing *Petitioner* to run immediately into federal court to seek an injunction compelling arbitration. *Id.*[13] The Federal Arbitration Act, this Court's prior decisions, and clearly established Third Circuit law all demonstrate, however, that such extraordinary action is not a prerequisite to preserving the right to an independent judicial determination of arbitrability. Moreover, mandating immediate resort to the

[13] This alternative was in fact not a viable one for the Kaplans, because the Exchange arbitration rules provide for the entry of awards against parties who fail to appear. R. 296. As Petitioner itself recognizes, Pet. Br. at 19, a party cannot simply refuse to participate in arbitration in such circumstances, but instead must —under Petitioner's approach—itself seek immediate judicial intervention.

courts in every instance in which a party seeks an independent judicial determination of arbitrability would frustrate the federal policies favoring enforcement of arbitration agreements, efficient resolution of disputes, and judicial economy.

A third alternative noted by Petitioner, which it relegates to a footnote, is that a party opposing arbitrability could object and refuse to allow the arbitrator to decide that question, thereby preserving it for *de novo* judicial review, while nonetheless proceeding to arbitrate the merits. *See* Pet. Br. at 19 n.2. Aside from serious practical questions regarding how a party could raise the arbitrability issue but keep the arbitrator from deciding it, this procedure is manifestly inefficient. It would require arbitrators to proceed blindly with arbitrations despite the existence of unexamined jurisdictional objections, only to have federal courts render the arbitration a nullity where those objections prove to be meritorious—as the arbitrators themselves might have concluded. Such a rule would impose unnecessary burdens on both parties and arbitrators and, not surprisingly, finds no support in the Federal Arbitration Act or this Court's prior decisions.

It is undisputed that the Kaplans never signed an arbitration provision,[14] refused to sign a submission agreement, and filed timely objections to arbitral jurisdiction. The Kaplans never agreed to give the arbitrators authority to make a binding determination of arbitrability and never agreed to forego independent judicial review. Under the Federal Arbitration Act and this Court's prior decisions, the Kaplans did everything they were required to do in order to preserve their right to *de novo* judicial review of arbitrability.

[14] Indeed, the fact that, as part of the workout, MKI and First Options signed an arbitration agreement and the Kaplans did not demonstrates a deliberate decision by the Kaplans not to arbitrate—a decision in which First Options acquiesced. *See* Pet. App. A26-A27.

A. Because The Parties Did Not Clearly And Unmistakably Provide That The Question Of Arbitrability Was For The Arbitrators And Not The Courts, The Court Of Appeals Properly Reviewed Arbitrability *De Novo*.

Petitioner concedes, as it must, that it is ordinarily "for the court, not the arbitrator, to decide in the first instance whether [a] dispute [is] to be resolved through arbitration." Pet. Br. at 13 (quoting *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. at 651). As this Court has held:

> *The question of arbitrability . . . is undeniably an issue for judicial determination.* Unless the parties *clearly and unmistakably* provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator.

Id. at 649 (emphasis added); *see also id.* at 647 (emphasis added) (" 'general rule' [is] that the issue of arbitrability is for the courts to decide unless the parties *stipulate* otherwise").

This rule "follows inexorably" from the principle that " 'arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.' " *Id.* at 648 (quoting *United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960)). Although federal courts will broadly construe the scope of an acknowledged agreement to arbitrate, no presumption of arbitrability applies to the determination of whether a party has entered into an arbitration agreement. *See McCarthy v. Azure*, 22 F.3d 351, 355 (1st Cir. 1994) ("federal policy [favoring arbitration] does not extend to situations in which the identity of the parties who have agreed to arbitrate is unclear"); *Case Int'l Co. v. T.L. James & Co.*, 907 F.2d 65, 67 (8th Cir. 1990) ("We are not inclined to find that a party has waived its right to ordinary judicial process without an express and specific agreement.").

Petitioner contends that where the parties "submit" the arbitrability issue to the arbitrator, the arbitrator's jurisdictional determination is entitled to deference. Pet. Br. at 13-32. Petitioner goes on to equate objecting to arbitrability before the arbitrator with formal "submission" of that issue to binding arbitration, but the two are quite distinct.[15]

"In the arbitration context, the 'submission,' of course, refers to the specific contract or agreement stating the precise issues to be arbitrated." *Davis v. Chevy Chase Fin. Ltd.*, 667 F.2d 160, 164 n.7 (D.C. Cir. 1981) (citing C. Updegraff, *Arbitration and Labor Relations* 125 (1970)). *Cf. Brotherhood of Painters & Allied Trades, Glaziers & Glass Workers Local No. 558 v. Lord & Burnham Constr. Corp.*, 705 F.2d 998, 999 (8th Cir. 1983) (citation omitted) ("Although the parties may specifically agree to submit questions of arbitrability to arbitration, the . . . contract's arbitration clause does not contain such an agreement."). A finding that parties have "submitted" a jurisdictional question to an arbitrator requires "clear[] and unmistakabl[e]" evidence that they agreed to do so. *See AT&T*, 475 U.S. at 647 (emphasis added) (general rule is that "arbitrability is for the courts to decide unless the parties *stipulate* otherwise").

Here, Petitioner cannot and does not contend that the parties expressly "agreed" or "stipulated" that the arbitrators could define their own jurisdiction. Instead, Petitioner contends that the Kaplans' motion to dismiss on jurisdic-

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[15] Where the parties do formally agree to submit the jurisdictional issue to the arbitrator for conclusive determination—*i.e.*, by stipulation or in a submission agreement—deferential judicial review may well be appropriate. *See Warrior & Gulf*, 363 U.S. at 583 n.7. The *Warrior & Gulf* Court cautioned, however, that in contending that such an agreement had been made, "the claimant must bear the burden of a *clear demonstration of that purpose.*" *Id.* (emphasis added). First Options cannot carry that burden here, because the Kaplans never agreed to submit *any* issue to the arbitrators.

tional grounds somehow substituted for such an express agreement. The Kaplans' vigorous denial before the arbitrators that they had agreed to arbitrate any dispute with First Options cannot fairly be turned around and cited as evidence of the requisite "clear and unmistakable" agreement.

The Kaplans refused to sign an agreement submitting *any* issue to the arbitrators. Where, as here, the party opposing arbitrability does not agree to submit the jurisdictional issue to the arbitrators for final decision, this Court's precedents require *independent* judicial review of arbitrability. *See AT&T Technologies,* 475 U.S. at 647, 649, 651; *Warrior & Gulf,* 363 U.S. at 582.

First Options' contention that the Kaplans agreed to commit the jurisdictional question to the arbitrator is belied not only by the Kaplans' conduct and the plain language of the parties' agreement, but also by common sense. Where, as in many labor disputes, the parties have an acknowledged agreement to arbitrate some controversies and the only question is whether a particular issue is arbitrable, the parties may well agree (and often do) to let the arbitrator make a binding determination of arbitrability. By contrast, where, as here, a party contends that it never agreed to arbitrate *any* dispute, that party is highly unlikely to be willing to commit the jurisdictional question to the arbitrator for final decision.

Following *AT&T Technologies,* several courts of appeals, in addition to the court below, have held that where, as here, a party refuses to sign a submission agreement and unsuccessfully argues jurisdictional objections to an arbitrator, federal courts should review the arbitrator's jurisdictional determination *de novo. See, e.g., Cargill Rice, Inc. v. Empresa Nicaraguense Dealimentos Basicos,* 25 F.3d 223 (4th Cir. 1994); *Alberici-Eby v. Local 520, Int'l Union of Operating Engineers,* 992 F.2d 727 (7th Cir. 1993). Other courts of appeals had reached the same conclusion even before this Court's decision in *AT&T Technologies. See, e.g., Davis v. Chevy Chase Fin. Ltd.,*

667 F.2d 160 (D.C. Cir. 1981); *Mobil Oil Corp. v. Local 8-766, Oil, Chem. & Atomic Workers Int'l Union,* 600 F.2d 322 (1st Cir. 1979).

Petitioner complains that *de novo* review of arbitrators' jurisdictional determinations allows the party opposing arbitration "repeated bites of the apple." Pet. Br. at 14. Exactly the same result obtains, however, where a party unsuccessfully challenges jurisdiction in federal district court. In such cases, the court of appeals reviews the jurisdictional decision independently after the district court renders its judgment on the merits. The Court of Appeals for the Third Circuit drew this analogy in *Local 719, American Bakery & Confectionery Workers v. National Biscuit Co.,* 378 F.2d 918 (3d Cir. 1967):

> In our own federal litigation system we require no special jurisdictional appearances and permit no interlocutory appeals from a court's decision in favor of its jurisdiction. Since federal labor policy with respect to arbitration favors the establishment of a private juridical system, there is even less reason to make resort to interstitial judicial activity mandatory, when the possibility exists that a labor dispute can be settled without any use of the courts whatsoever. Thus, where as here the reluctant party has presented its objection to arbitrability to the arbitrator and has not thereafter clearly indicated its willingness to forego judicial review, we believe that the issue is sufficiently preserved for our subsequent inquiry.

Id. at 921-22 (footnotes omitted). *See also Davis,* 667 F.2d at 168 ("[W]e agree with the court in *Local 719* that such a rule [limiting judicial review of an arbitrator's determination of arbitrability] might actually *foster* litigation by requiring parties disputing arbitrability to seek 'interlocutory' review of jurisdictional rulings.").

Moreover, Petitioner could have asked the federal district court to compel arbitration when the Kaplans refused to sign a submission agreement and formally ob-

jected to arbitral jurisdiction. *See* 9 U.S.C. § 4; *see also Marine Int'l Nominees v. Republic of Guinea*, 693 F.2d 1094, 1097 (D.C. Cir. 1982), *cert. denied*, 464 U.S. 815 (1983); *National R.R. Passenger Corp. v. Missouri Pac. R.R. Co.*, 501 F.2d 423, 425 (8th Cir. 1974). *Cf. Associated Brick Mason Contractors v. Harrington*, 820 F.2d 31, 38 (2d Cir. 1987) (cause of action to compel arbitration accrues when party rejects written demand for arbitration). Petitioner *chose* not to do so and, therefore, should not be heard to complain about having to litigate the jurisdictional issue more than once.

Additionally, it was First Options that *chose* to file for arbitration of its dispute with the Kaplans, even though it knew that neither Manuel nor Carol Kaplan had ever signed any document containing an arbitration provision. As the largest clearinghouse at the Exchange, First Options undoubtedly sought to gain a home-court advantage before a favorably pre-disposed Exchange Arbitration Panel. Now that the court of appeals has foiled First Options' jurisdictional gambit, First Options claims to have been treated unfairly. There is no unfairness in allowing the federal courts to prevent parties who have not agreed to arbitrate from being forced to do so.

Rather, as the Seventh Circuit has reasoned, allowing *de novo* judicial review of arbitrability determinations simply places the parties on equal footing:

> The party initiating arbitration has made a decision that the dispute is arbitrable when it initiates an arbitration proceeding. If that party felt the dispute was not arbitrable it would have chosen a forum other than arbitration. Thus, permission for the non-initiating party to preserve arbitrability objections following the arbitration hearing merely permits the non-initiating party to make the same decision concerning arbitrability that the initiating party made prior to submission of the decision to arbitrate and does not discriminate against the initiating party. Indeed, such a rule frequently is beneficial to the party who initiated arbitration in allowing that party access to the arbitral process without the necessity of the filing of a lawsuit to compel arbitration.

International Ass'n of Machinists & Aerospace Workers, Lodge No. 1777 v. Fansteel, Inc., 900 F.2d 1005, 1009 (7th Cir.), *cert. denied*, 498 U.S. 851 (1990).

B. The Language And Structure Of The Federal Arbitration Act Support *De Novo* Judicial Review Of Arbitrators' Jurisdictional Determinations.

Section 10(a)(4) of the Federal Arbitration Act provides that district courts may vacate an arbitration award "[w]here the arbitrators exceeded their powers." Courts have interpreted this provision to permit vacatur of arbitration awards where the arbitrators lacked jurisdiction. *See, e.g., Delta Queen Steamboat Co. v. District 2 Marine Eng'rs Beneficial Ass'n*, 889 F.2d 599, 602 (5th Cir. 1989), *cert. denied*, 498 U.S. 853 (1990); *Davis*, 667 F.2d at 164 n.7; *Mobil Oil Corp.*, 600 F.2d at 326; *Orion Shipping & Trading Co. v. Eastern States Petroleum Corp.*, 312 F.2d 299, 300 (2d Cir.), *cert. denied*, 373 U.S. 949 (1963). It is hard to imagine a clearer example of arbitrators exceeding their powers than where they assert jurisdiction over, and enter awards against, parties who never agreed to arbitrate.

There is no indication in section 10(a)(4), or anywhere else in the Act, that federal courts should defer to arbitrators in determining whether the arbitrators "exceeded their powers." Thus, on the face of the Act, the inquiry under section 10(a)(4) should be *de novo*.

Petitioner argues that the Federal Arbitration Act "provides a clear mechanism for a party that objects to arbitration on jurisdictional grounds to obtain a judicial ruling on arbitrability in the first instance." Pet. Br. at 18. The Act does nothing of the sort; it provides *no means* for an objecting party to do what Petitioner says it must do—secure a stay of arbitration and resort to court for

a judicial ruling on arbitral jurisdiction. *See Tai Ping Ins. Co. v. M/V Warschau*, 731 F.2d 1141, 1144 (5th Cir. 1984) ("There is no provision in the Act for a stay of arbitration."). *Cf. Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 476 (1989) (Act contains no provision authorizing stay of arbitration pending resolution of related litigation).[16] The only stay provision in the Act authorizes parties *desiring* arbitration to seek a stay of *judicial* proceedings. *See* 9 U.S.C. § 3. Indeed, Petitioner is reduced to Orwellian doublespeak in arguing that the procedural mechanism provided by the Act for parties objecting to arbitration is "the opportunity to defend against a section 3 or section 4 application." Pet. Br. at 19. The "opportunity" to be a defendant is a curious procedural protection;[17] the failure of the Act to provide a means for an objecting party to obtain a prior judicial ruling on arbitrability strongly suggests that Congress did not view such a *prior* ruling as a prerequisite to preserving the party's conceded right to a *de novo* judicial determination.

On the face of the Act, the *only* ways to remedy arbitrators' jurisdictional excesses are: (1) a petition to vacate the award under section 10(a)(4); or (2) a petition to modify or correct an award under section 11(b). *See Davis*, 667 F.2d at 164 n.7 ("power to review arbitration awards made with regard to nonarbitral matters derives from both" § 10(a)(4) and § 11(b)). Because "the issue of arbitrability is for the courts to decide," *AT&T Technologies*, 475 U.S. at 647, review of arbitrability under these sections should be *de novo*.

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[16] Declaratory judgments and injunctions blocking arbitration are general judicial remedies for unjustified arbitral assertions of jurisdiction; such remedies are not provided by the Act. *Tai Ping Ins. Co.*, 731 F.2d at 1144.

[17] This "opportunity" is not even present where, as here, the pertinent arbitration rules contain a default provision. *See* note 13, *supra*.

C. The Federal Policies Favoring Enforcement Of Private Arbitration Agreements, Efficient Resolution Of Disputes, And Judicial Economy All Support Allowing A Defendant To Argue Jurisdictional Objections To An Arbitrator Without Waiving Its Right To *De Novo* Judicial Review Of Arbitrability.

The principal purpose of the Federal Arbitration Act is "to ensure judicial enforcement of privately made agreements to arbitrate." *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219 (1985). *See Allied-Bruce Terminix Cos., Inc. v. Dobson*, No. 93-1001 (Jan. 18, 1995). No federal policy favors arbitration where, as here, the parties have not agreed to arbitrate. *See Volt*, 489 U.S. at 478; *AT&T Technologies*, 475 U.S. at 648. "[T]he federal policy is simply to ensure the enforceability, according to their terms, of private *agreements* to arbitrate." *Volt*, 489 U.S. at 476 (emphasis added).

Indeed, requiring courts to defer to arbitrators' jurisdictional decisions would deter parties from entering into arbitration agreements. As this Court has noted, "[t]he willingness of parties to enter into agreements that provide for arbitration of specified disputes would be 'drastically reduced' . . . if [an] arbitrator had the 'power to determine his own jurisdiction. . . .'" *AT&T Technologies*, 475 U.S. at 651 (quoting Cox, *Reflections Upon Labor Arbitration*, 72 Harv. L. Rev. 1482, 1509 (1959)). Therefore, to the extent the courts have an interest in encouraging arbitration agreements, that interest would be furthered by a rule allowing meaningful judicial review of arbitrators' jurisdictional rulings.

Requiring parties to seek a stay of arbitration in order to obtain an independent judicial determination of arbitrability would also frustrate a second purpose of the Act: the efficient and speedy resolution of disputes. *See Byrd*, 470 U.S. at 220-21. Petitioner's rule would force arbitral defendants to interrupt the arbitral process at the outset whenever they possessed a jurisdictional objection. Such a manifestly inefficient result should be avoided. *See Jones Dairy Farm v. Local No. P-1236, United Food & Commercial Workers Int'l Union*, 760 F.2d 173, 175

(7th Cir.) (Posner, J.) ("It is desirable to put as much of the case as possible to the arbitrator, and not encourage parties to go to court before the arbitration can begin"), *cert. denied*, 474 U.S. 845 (1985).[18] As the court below explained, "[f]ederal courts encourage participation in arbitration. Requiring parties to refuse to participate in order to challenge arbitral jurisdiction would not advance this goal." Pet. App. A17.

A rule allowing an arbitration to proceed while jurisdictional objections are preserved for *de novo* judicial review makes it possible for the entire controversy to be resolved by the arbitral process, with its concomitant speed and efficiency. As Professor Siegel observed:

> It may well happen, of course, that the person opposing the arbitration has won it on the merits, either in full or at least in sufficient measure to accept the award, and that the victory will induce the abandonment of the objection to the arbitral forum. (Winning the battle always helps the winner forget who chose the battlefield.)

David D. Siegel, *Appeals from Arbitrability Determinations Under the New § 15 of the U.S. Arbitration Act*, 126 F.R.D. 589, 594 (1989).[19]

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[18] Petitioner cites *Jones Dairy Farm* for the proposition that when a party presents the arbitrability question to the arbitrator, courts will not "second-guess" the arbitrator's decision on that issue. *See* Pet. Br. at 29 n.4. The case, however, does not support that proposition. Indeed, the rule in the Seventh Circuit is to the contrary. *See Alberici-Eby*, 992 F.2d at 732; *Edward D. Jones & Co. v. Sorrells*, 957 F.2d 509, 514 (7th Cir. 1992); *Fansteel*, 900 F.2d at 1009-10.

In *Jones Dairy Farm*, the parties "never questioned the arbitrator's authority" until after the award had been entered. 760 F.2d at 175. The court of appeals therefore held that "by submitting without a peep to the arbitrator's jurisdiction," Jones Dairy Farm waived its right to contest arbitrability in court. *Id.* at 176. The Kaplans, by contrast, vigorously contested the arbitrator's jurisdiction from the outset.

[19] Petitioner itself asserts that the approach of the Third Circuit "encourages a party to present its case on arbitrability and on the merits to the arbitrator" (Pet. Br. at 25)—serving the very policy Petitioner discerns in the Federal Arbitration Act. Petitioner goes on to note that the objecting party in presenting its case will be "secure in the knowledge that if it loses it can reopen the arbitrability issue for *de novo* review by the court," *id.*, but that is equally true, for example, of similar jurisdictional rulings by district courts, and is simply a function of the fact emphasized by this Court in *AT&T*—that arbitrability is for courts, not arbitrators, to decide.

Petitioner's rule would be particularly inefficient where, as here, some arbitral defendants object to jurisdiction and some do not. If the arbitration were allowed to proceed as to the non-objecting defendants while the court considered the jurisdictional issue, duplicative arbitral proceedings involving the objecting defendants would ensue if the court rejected the jurisdictional objections. If, on the other hand, the arbitration were stayed as to all parties pending resolution of the jurisdictional objections, the parties without jurisdictional objections would be delayed unnecessarily from resolving their disputes.

In the instant case, by contrast, the arbitration was allowed to proceed as to all parties, and the court addressed the jurisdictional objections at the conclusion of the arbitration. No matter how the court ruled on the jurisdictional objections, no further arbitral proceedings would have been required.

Finally, considerations of judicial economy weigh heavily against adopting Petitioner's proposed rule.[20] Requiring objecting arbitrants to seek immediate declaratory and injunctive relief in order to obtain an independent judicial

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[20] We agree with Petitioner that one of the beneficial results of arbitration agreements is that they reduce the workload of the federal courts. *See* Pet. Br. at 25-26. The reduction in court dockets that Petitioner argues would accompany adoption of its proposal is based solely on the different standard of review it would have a court apply. While it may well be that a more deferential standard would discourage some objecting parties from pursuing the jurisdictional issue in the courts, any such reduction would be more than outweighed by the additional court actions at the outset of arbitration that Petitioner's approach would require.

ruling on arbitrability would force the federal courts to become involved every time a jurisdictional objection were raised, resulting in additional burdens on crowded court dockets and additional expense to the parties. Moreover, such a rule would require the federal courts to address disputes prematurely, rather than waiting to see whether the disputes could be resolved satisfactorily without court involvement. Conversely, the rule applied by the court of appeals in this case allows the arbitration process an opportunity to obviate the need for court involvement. *See Fansteel*, 900 F.2d at 1009 ("In permitting an arbitrator to attempt to address a dispute prior to a judicial arbitrability determination, parties may well be able to resolve their disputes without requiring the involvement of the judiciary.").

As the D.C. Circuit has reasoned:

> Although we are aware of decisions suggesting that review of an arbitrator's determinations of arbitrability should be limited, *see, e.g., Yakima Newspaper Guild, Local 27 v. Republic Publishing Co.*, 375 F. Supp. 945, 947 (E.D. Wash. 1974), we agree with the court in *Local 719* that such a rule might actually *foster* litigation by requiring parties disputing arbitrability to seek "interlocutory" review of jurisdictional rulings. [*Davis*, 667 F.2d at 168 (citing *Local 719*, 378 F.2d at 921).]

Petitioner suggests in a footnote that a party may be able to obtain an independent judicial decision on arbitrability " 'by simply not giving the arbitrability question to the arbitrator for decision,' but instead expressly 'reserving that question for later judicial determination.' " Pet. Br. at 19 n.2 (quoting *George Day Constr. Co. v. United Bhd. of Carpenters & Joiners, Local 354*, 722 F.2d 1471, 1476 (9th Cir. 1984)). Petitioner completely fails to explain how, as a practical matter, a party could keep an arbitrator who wished to address jurisdictional objections from doing so.

Moreover, under this procedure, arbitrators would be required to proceed to the merits of an arbitration, despite the possibility that they themselves might conclude, after hearing the parties' arguments, that they lack jurisdiction. Such a process is obviously inefficient and would engender a massive waste of time and resources by parties and arbitrators alike. It makes far more sense to allow arbitrators, aided by the parties' arguments, the chance to act as their own gatekeepers in the first instance.

There is, of course, some cost in not insisting—as Petitioner would—that the *de novo* judicial determination of arbitrability take place in every instance before arbitration. If a reviewing court determines that the arbitrator lacked jurisdiction, the time spent before the arbitrator will in a sense have been wasted. But that loss is plainly outweighed by the clear gains in reduced judicial involvement (because the arbitrator's decision may render resort to the courts unnecessary or may dissuade the objecting party from the desirability of such resort) and by the increased respect for the arbitral process (because courts are not required to intrude at the outset of the process in every case of a jurisdictional objection and parties are not required to stonewall an arbitrator to protect their right to *de novo* judicial review of arbitrability). This cost/benefit analysis should seem familiar; it tracks the similar calculus underlying the final judgment rule. In applying that rule, this Court has recognized that any losses caused by generally requiring district courts to decide the merits before a reviewing court can address a jurisdictional objection are outweighed by gains in judicial economy and efficiency and institutional respect for the district courts. *See, e.g., Digital Equip. Corp. v. Desktop Direct, Inc.*, 114 S. Ct. 1992 (1994); *Richardson-Merrell, Inc. v. Koller*, 472 U.S. 424, 430 (1985); *Firestone Tire & Rubber Co. v. Risjord*, 449 U.S. 368, 374 (1981).

D. It Would Be Fundamentally Unfair To Deny Respondents *De Novo* Judicial Review Of Arbitrability Under The Circumstances Of This Case.

Neither Manuel nor Carol Kaplan signed any agreement to arbitrate any dispute with First Options. As the court of appeals held:

> These [workout] documents limited the Kaplans' obligations to the contribution of certain fixed sums and contained no promise to arbitrate. Thus, though we will separately consider all three of First Options' variations on the theme of consent, the common denominator which applies to all is the absence of any agreement to arbitrate in the only workout document the Kaplans signed as individuals. [Pet. App. A24.]

Despite the absence of any agreement to arbitrate their dispute with First Options, the Kaplans were hauled into arbitration before the Exchange, in which First Options was the largest clearinghouse. J.A. 65. Faced with the prospect of litigating sizable claims in a hostile arbitral forum they never agreed to, the Kaplans refused to sign a submission agreement and filed formal objections to Exchange jurisdiction. Pet. App. A18; J.A. 54-55. After some limited discovery had taken place, the Kaplans reiterated their jurisdictional objections in a formal motion to dismiss, which the arbitrators summarily denied. J.A. 55.

After thus putting the arbitrators and First Options on notice of their substantial (and meritorious) jurisdictional objections, the Kaplans participated in the arbitration hearing. Never during the course of the arbitration did the Kaplans "indicate[] [a] willingness to forego judicial review" of their jurisdictional objections.[21]

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[21] Under Third Circuit law, arbitrability objections are fully preserved unless a party "'clearly indicate[s] his willingness to forego judicial review.'" *Pennsylvania Power Co. v. Local Union No. 272*, 886 F.2d 46, 50 (3d Cir. 1989) (quoting *Local 719, American Bakery & Confectionery Workers v. National Biscuit Co.*, 378 F.2d 918, 921-22 (3d Cir. 1967)).

On appeal of the arbitrators' award in favor of First Options, the court of appeals correctly found that, as the Kaplans had maintained from the outset, the arbitrators lacked jurisdiction over the Kaplans. Pet. App. A3-A4. Now, First Options contends that because the Kaplans did not seek to enjoin the arbitration proceedings, the court of appeals should have deferred to the arbitrators' assertion of jurisdiction.

Under settled Third Circuit law, the Kaplans were not required to seek a stay of arbitration in order to preserve their jurisdictional objections for *de novo* judicial review. *See Pennsylvania Power Co. v. Local Union No. 272*, 886 F.2d 46, 50 (3d Cir. 1989); *International Bhd. of Teamsters, Chauffeurs, Warehousemen and Helpers, Local 249 v. Western Pa. Motor Carriers Ass'n*, 574 F.2d 783, 787 (3d Cir.), *cert. denied*, 439 U.S. 828 (1978); *Local 719*, 378 F.2d at 921-22. *See also AT&T Technologies*, 475 U.S. at 649 (emphasis added) ("Unless the parties *clearly and unmistakably* provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator.").[22]

The Kaplans did everything required under applicable law to preserve their meritorious jurisdictional objections for *de novo* judicial review.[23] It would be fundamentally unfair to devise a new, judge-made rule and apply it to the Kaplans, potentially saddling them with an enormous judgment unsupported by the facts, *see* Pet. App. A52, entered by a tribunal that lacked jurisdiction. Pet. App. A3-A4.

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[22] Nor were the Kaplans required to forego litigation of Mr. Kaplan's counterclaim. *See* Pet. App. A21 (citing cases).

[23] The fact that the Kaplans did everything required by Third Circuit law to preserve their jurisdictional objections for *de novo* judicial review provides additional evidence that they never intended to submit the jurisdictional issue to the arbitrators for final decision.

E. Even If The Courts Were To Review The Arbitrators' Assertion Of Jurisdiction With Deference, The Award Against The Kaplans Could Not Stand.

As noted above, the Kaplans never signed any document containing an arbitration agreement. Pet. App. A24. Only one of the four contracts comprising the workout from which the instant dispute arises contained an arbitration provision, and that contract was signed only by First Options and MKI. J.A. 30-36, 57. Manuel and Carol Kaplan individually signed only one of the four contracts (the Letter Agreement), and that contract did not contain an arbitration clause. J.A. 4-23.

As the court of appeals held:

> The circumstances of this case *plainly negate* the Kaplans' consent to arbitrate their individual responsibility for MKI's obligations. . . . There is *no ambiguity* about the absence of any consent to arbitrate in the documents the Kaplans signed individually. [Pet. App. A26-A27 (emphases added).]

Even under the deferential review accorded an arbitrator's decision on the merits (as opposed to the contested arbitrability) of a controversy, an award must be vacated when it is in manifest disregard of the parties' agreement. *Exxon Shipping Co. v. Exxon Seamen's Union*, 993 F.2d 357, 360 (3d Cir. 1993). "[A]n arbitrator is confined to interpretation and application of the . . . agreement; he does not sit to dispense his own brand of industrial justice." *United Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 596 (1960).[24]

Thus, an arbitral award should be vacated "where an arbitrator 'manifest[s] an infidelity' to her obligation to interpret the contract, [or] ignores a plain and unam-

[24] *See also St. Louis Theatrical Co. v. St. Louis Theatrical Bhd. Local 6*, 715 F.2d 405, 407-09 (8th Cir. 1983) (arbitrator is not free to impose his own sense of fairness); *Totem Marine Tug & Barge, Inc. v. North Am. Towing, Inc.*, 607 F.2d 649, 651 (5th Cir. 1979).

biguous provision of the contract." *Apex Fountain Sales, Inc. v. Kleinfeld*, 818 F.2d 1089, 1094 (3d Cir. 1987) (citations omitted); *see also id.* at 1096 n.5 (citing cases); *Inter-City Gas Corp. v. Boise Cascade Corp.*, 845 F.2d 184, 187 (8th Cir. 1988) ("Although the arbitrator may interpret ambiguous language, the arbitrator may not disregard or modify unambiguous contract provisions."). Where the language of a contract is clear and unambiguous, an arbitrator is bound to enforce that language, which represents the bargain of the parties. Failure to do so mandates vacatur.

> "The arbitrator may not ignore the plain language of the contract. . . ." If the language of an agreement is clear and unequivocal, an arbitrator cannot give it a meaning other than that expressed by the agreement.

Georgia-Pacific Corp. v. Local 27, United Paperworkers Int'l Union, 864 F.2d 940, 944 (1st Cir. 1988) (quoting *United Paperworkers Int'l Union v. Misco, Inc.*, 484 U.S. 29, 38 (1987)); *accord, AP Parts Co. v. UAW*, 923 F.2d 488, 491-92 (6th Cir. 1991) (award vacated where "arbitrator ignored the plain language of the contract and rendered an award outside the purview of his authority"); *Leed Architectural Prods., Inc. v. United Steelworkers, Local 6674*, 916 F.2d 63, 65 (2d Cir. 1990); *Tootsie Roll Indus., Inc. v. Local Union No. 1, Bakery, Confectionery & Tobacco Workers Int'l Union*, 832 F.2d 81, 84 (7th Cir. 1987).

Here, as the court of appeals determined, there was "no ambiguity" about the lack of any consent by the Kaplans to arbitrate. Pet. App. A27. Therefore, even under a deferential standard of review,[25] the arbitrators' assertion of jurisdiction over the Kaplans cannot stand.

[25] It is not at all clear what Petitioner means by a "deferential" review as to arbitral jurisdiction, but whatever standard is applied, here there was no agreement to arbitrate and no jurisdiction. No amount of deference can create an agreement where it does not

II. THE COURT OF APPEALS PROPERLY REVIEWED THE DISTRICT COURT'S DENIAL OF VACATUR UNDER ORDINARY STANDARDS OF APPELLATE REVIEW.

The court of appeals, in conformity with the well-established law of the Third Circuit and at least eight other circuits,[26] reviewed the district court's denial of the motion to vacate "*de novo*." In the court of appeals' words:

> We will exercise plenary review over the district court's determination that the arbitration panel had jurisdiction over the Kaplans insofar as it turns on questions of law. To the extent that the district court's determination of arbitral jurisdiction turns on findings of fact, however, our scope of review will be limited to whether those findings are clearly erroneous. [Pet. App. A15 (citation omitted).]

This was not only consistent with the law of nine circuits, it was an exercise of what Petitioner itself describes as "ordinary standards of appellate review." Pet. Br. at 36. Petitioner, however, asks this Court to adopt the more deferential "abuse of discretion" standard for appeals from district court decisions confirming or refusing to vacate arbitration awards, while retaining the ordinary, more exacting standard of review where district courts vacate or refuse to confirm arbitration awards.

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exist, and no amount of deference can confer jurisdiction on an arbitral panel that does not otherwise possess it.

[26] *See Advest, Inc. v. McCarthy*, 914 F.2d 6, 8 (1st Cir. 1990); *In re Arbitration No. AAA 13-161-0511-85*, 867 F.2d 130, 131 (2d Cir. 1989); *Amerada Hess Corp. v. SS Athena*, 1987 WL 37022, at *1 (4th Cir. Apr. 9, 1987) (unpublished decision), *cert. denied*, 484 U.S. 848 (1987); *McIlroy v. PaineWebber, Inc.*, 989 F.2d 817, 819-20 (5th Cir. 1993); *Moseley, Hallgarten, Estabrook & Weeden v. Ellis*, 849 F.2d 264, 267 (7th Cir. 1988); *Pack Concrete, Inc. v. Cunningham*, 866 F.2d 283, 284 (9th Cir. 1989); *Bowles Fin. Group, Inc. v. Stifel, Nicolaus & Co.*, 22 F.3d 1010, 1012 (10th Cir. 1994); *Parmac, Inc. v. I.A.M. Nat'l Pension Fund Benefit Plan A*, 872 F.2d 1069, 1071 (D.C. Cir. 1989).

Petitioner argues that this rule, recently pronounced by the Eleventh Circuit, should be adopted because it "properly reflects federal arbitration policy." Pet. Br. at 34. Appellate standards of review, however, are functions of the respective capabilities and institutional needs of trial and appellate courts,[27] not means of promoting substantive policies by having courts of appeals place a thumb on the scales in favor of certain substantive outcomes.[28] Accordingly, this Court should reject the so-called "hybrid" or "bifurcated" standard of review, which would divert the courts of appeals from their traditional role of correcting error and promoting doctrinal uniformity,[29] and relegate them to the role of result-driven rubber stamps. The judgment of the court of appeals should be affirmed as a proper exercise of ordinary appellate review.

A. The Standard Of Appellate Review Should Not Depend On The Outcome In The Court Below.

Appellate standards of review are determined by the respective capabilities and duties of trial and appellate

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[27] *See Salve Regina College v. Russell*, 499 U.S. 225, 231, 233 (1991) ("As a general matter, of course, the courts of appeals are vested with plenary appellate authority over final decisions of district courts. . . . Those circumstances in which Congress or this Court has articulated a standard of deference for appellate review of district court determinations reflect an accommodation of the respective institutional advantages of trial and appellate courts.").

[28] *Cf. State Establishment for Agric. Prod. Trading v. M/V Wesermunde*, 770 F.2d 987, 991 n.5 (11th Cir. 1985) ("The policy favoring arbitration does not and may not control the determination of appellate jurisdiction.").

[29] *See Church of Scientology v. IRS*, 792 F.2d 153, 155 n.1 (D.C. Cir. 1986) ("appellate review serves a dual purpose: the correction of legal error and the establishment of legal rules for future guidance"), *aff'd*, 484 U.S. 9 (1987); A.B.A. Commission on Standards of Judicial Administration, Standards Relating to Appellate Courts (1977) 3.00 commentary ("The appellate courts have two functions: to review individual cases to assure that substantial justice had been rendered, and in connection therewith to develop the law for general application in the legal system.").

courts. Appellate courts, which have the power to bind courts throughout their jurisdiction as well as the advantages of time for unhurried deliberation, "reflective dialogue and collective judgment," *Salve Regina College*, 499 U.S. at 232, have primacy on matters of law and exercise plenary review of legal conclusions. Trial courts, on the other hand, have more experience as factfinders and are closer to the evidence, and accordingly their findings of fact may be reversed only if clearly erroneous. *See Anderson v. City of Bessemer*, 470 U.S. 564, 574 (1985) ("The trial judge's major role is the determination of fact, and with experience in fulfilling that role comes expertise."). Day-to-day docket, discovery, and trial management responsibilities require the balancing of numerous interrelated concerns, and accordingly rulings in this area are reviewed only for abuse of discretion. *Salve Regina College*, 499 U.S. at 233 (it is especially common for issues "involving supervision of litigation to be reviewed for abuse of discretion").[30]

By subjecting only "anti-arbitration" decisions to ordinary appellate review, Petitioner would have this Court alter the established division of responsibility by making the standard of appellate review turn not on the nature of the issue presented on appeal, but instead on the way the district court decided the issue. Such a one-sided approach would permit legal errors to go uncorrected and skew the orderly development of the law.

Petitioner cites no other area of law in which courts of appeals apply such a "bifurcated" standard, depending on the outcome below. Nor does Petitioner cite any other area of law in which courts of appeals defer to a district

[30] *See also Founding Church of Scientology v. Webster*, 802 F.2d 1448, 1457 (D.C. Cir. 1986) ("The abuse of discretion standard calls on the appellate department, in a spirit of humility occasioned by not having participated in what has gone before, not just to scrutinize the conclusion but to examine with care and respect the process that led up to it."), *cert. denied*, 484 U.S. 871 (1987).

court's review of another entity's decision. Indeed, in other areas in which district courts review decisions of other entities, the courts of appeals apply ordinary principles of appellate review. *See, e.g., Novicki v. Cook*, 946 F.2d 938, 941 (D.C. Cir. 1991) ("We do not defer to a district court's review of an agency adjudication any more than the Supreme Court defers to a court of appeals' review of such a decision"); *In re G.S.F. Corp.*, 938 F.2d 1467, 1474 (1st Cir. 1991) ("the circuit courts that have considered the issue have uniformly held that in appeals from the decision of a district court on appeal from the bankruptcy court, the court of appeals independently reviews the bankruptcy court's decision"); *United States v. Lamon*, 930 F.2d 1183, 1187 (7th Cir. 1991) ("we review *de novo* the determination by the district court that the magistrate had a substantial basis for finding probable cause"); *Malarkey v. Texaco, Inc.*, 983 F.2d 1204, 1212-13 (2d Cir. 1993) (court of appeals reviews *de novo* district court's decision whether to overturn jury verdict). *See also Salve Regina College*, 499 U.S. at 231 (court of appeals reviews district court determination of state law *de novo*).[31]

Petitioner does not argue that district courts are better able to review arbitration awards under the applicable legal criteria, or that the smooth functioning of district courts requires that their confirmation of arbitral awards be given special deference. Rather, it argues that the "hybrid" rule would promote the "primary advantages of arbitration—speed and finality." Pet. Br. at 34. This argument proves too much. There is no reason to assume that courts of appeals will rule on cases under the abuse-of-discretion standard significantly more quickly than under the *de novo* standard. The standard of review is, at most, a minor factor in determining the amount of

[31] In these situations, too, appellants get more than one "bite at the apple," but this has not provoked an alteration of ordinary standards of appellate review.

time it takes to dispose of an appeal.[32] Indeed, given the highly subjective element inherent in abuse-of-discretion review, any gain in finality would be more than offset by the loss of predictability and consistency of outcome. *See* 1 S. Childress & M. Davis, *Standards of Review* 232 (1986) ("[T]he concept of discretion quite naturally fights uniformity, so it should not be surprising that review of discretion is not consistently applied or even theorized.").

Petitioner's contention that the "hybrid" rule "derives considerable support from the structure of the Arbitration Act," Pet. Br. at 34, is also without merit. Petitioner relies on Section 16 of the Act, which specifically permits appeals from orders which refuse to stay litigation in favor of arbitration, or which refuse to compel arbitration, 9 U.S.C. § 16(a)(1), while not permitting appeals of "interlocutory" orders which do stay litigation, refuse to enjoin arbitration, or compel arbitration, 9 U.S.C. § 16(b). Petitioner's argument fails, however, to account for the fact that Section 16 also permits appeals from "final" orders compelling arbitration. 9 U.S.C. § 16 (a)(3); *Stedor Enterprises, Ltd. v. Armtex, Inc.*, 947 F.2d 727, 730-31 (4th Cir. 1991); Siegel, *supra*, 126 F.2d at 590. More importantly, Section 16 was not intended to skew the appellate process in favor of arbitration, but rather to clarify the application of the final judgment rule in the context of arbitration-related district court proceedings.[33] It addresses the *timing* of appellate review, not the standard of review.

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[32] Petitioner does not address what would occur in the not uncommon situations where district courts vacate arbitration awards only in part, or where they modify awards and confirm them as modified. Presumably, courts of appeals will then have to apply both prongs of the "bifurcated" standard of review in a single appeal, resulting in no additional speed or finality, but only additional confusion.

[33] *See* 134 Cong. Rec. S16,309 (Oct. 14, 1988):

> [U]nder the proposed statute, appealability does not turn solely on the policy favoring arbitration. Appeal can be taken from final judgments, including a final judgment in an action to compel arbitration, a final judgment that refuses to enjoin arbitration, or a final judgment dismissing an action in deference to arbitration. These appeals preserve the general policy that appeal should be available where there is nothing left to be done in the district court.

B. The Court Of Appeals Exercised "Ordinary" Appellate Review.

Petitioner, in the alternative, urges this Court to reverse the court of appeals on grounds not raised in its petition for certiorari, namely that the court of appeals failed to apply "ordinary" standards of appellate review. Pet. Br. at 36-39. Because this issue is raised for the first time in Petitioner's Brief, it should not be considered. Sup. Ct. R. 24.1(a); *Taylor v. Freeland & Kronz*, 112 S.Ct. 1644, 1649 (1992). Even if the Court chooses to reach this issue, Petitioner's contention should be rejected.

Petitioner argues that the district court's conclusion that the arbitrators had jurisdiction was "fact-bound" and should have been "upheld under the clearly erroneous standard." Pet. Br. at 37. Notably, however, the district court did not view its task as involving the resolution of disputed issues of fact. To the contrary, the district court found that "the parties have stipulated to virtually all of the pertinent facts." Pet. App. C2.[34] The jurisdictional issues before the district court were issues of law "ordinarily" subject to plenary appellate review, especially where, as here, the underlying facts were undisputed.[35]

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[34] Indeed, Petitioner concedes that the "court of appeals did not dispute the facts underlying the district court's decision (many of which had been stipulated by the parties)." Pet. Br. at 31-32.

[35] *See, e.g., Bradford-White Corp. v. Ernst & Whinney*, 872 F.2d 1153, 1160 (3d Cir.), *cert. denied*, 493 U.S. 993 (1989); *R.M. Perez & Assocs. v. Welch*, 960 F.2d 534, 537 (5th Cir. 1992); *FSC Sec. Corp. v. Freel*, 14 F.3d 1310, 1311-12 (8th Cir. 1994); *Morris v. Commodity Futures Trading Comm'n*, 980 F.2d 1289, 1294 (9th Cir. 1992); *First Investors Corp. v. American Capital*

Finally, the court of appeals made it clear that "[t]o the extent that the district court's determination of arbitral jurisdiction turns on findings of fact . . . our scope of review will be limited to whether those findings are clearly erroneous." Pet. App. A15.

Thus, Petitioner's belatedly raised final argument is based on a misunderstanding of what both the district court and the court of appeals did in this case. It is clear from the record that the court of appeals properly exercised ordinary appellate review.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

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No. 94-560

In the Supreme Court of the United States

OCTOBER TERM, 1994

FIRST OPTIONS OF CHICAGO, INC.,
Petitioner,

v.

MANUEL KAPLAN, ET AL.,
Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENT CAROL KAPLAN

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QUESTIONS PRESENTED

1. Where the parties did not clearly and unmistakably agree that the question of arbitral jurisdiction was for the arbitrators and not for the courts, did the court of appeals properly review *de novo* the arbitrators' assertion of jurisdiction over the controversy?

2. Did the court of appeals properly apply ordinary appellate review to the district court's refusal to vacate the arbitration award, rather than altering the standard of appellate review based on the outcome of the district court proceedings?

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ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
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BRIEF FOR RESPONDENT CAROL KAPLAN

STATEMENT OF THE CASE

Respondent Carol Kaplan ("Mrs. Kaplan") adopts and incorporates by reference the Statement of the Case found in the Brief for Respondent Manuel Kaplan and supplements it as follows. Mrs. Kaplan is the wife of Respondent Manuel Kaplan ("Mr. Kaplan"). Mr. Kaplan has been the president, a director and sole shareholder of Respondent MK Investments, Inc. ("MKI"), formerly a stock options market maker on the Philadelphia Stock Exchange (the "Exchange"), since 1986. (Pet. App. at A-5.) Mrs. Kaplan has never had any ownership interest in MKI, nor has she ever been a member of the Exchange (J.A. 65).

The Work-Out Agreement

Shortly after the stock market crash of October 19, 1987, MKI entered into negotiations with its clearing firm, Petitioner First Options of Chicago, Inc. ("First Options"), toward the work-out of MKI's disputed debt to First Options arising out of trading losses sustained in the wake of the crash. First Options pressed Mr. Kaplan to assume personal liability for MKI's obligations. Mr. Kaplan refused. Instead, he and MKI disputed the size of MKI's deficit and claimed that First Options mishandled the liquidation of the MKI trading account. (Pet. App. at A-6.)

On March 24, 1988, MKI executed four documents comprising a work-out of the dispute that had resulted from MKI's trading losses. The four work-out documents were:

> 1) A "Letter Agreement" in which MKI acknowledged an indebtedness of $6,227,188 to First Options, to be repaid through certain specified initial prepayments and thereafter out of future MKI trading profits, and which contained releases from personal liability in favor of Mr. Kaplan and several other individuals (J.A. 4-23);
>
> 2) A "Subordinated Loan Agreement" in which the work-out was structured as a loan to MKI, subject to the repayment provisions of the Letter Agreement (J.A. 30-36);
>
> 3) A "Guaranty" by MKI of the debt of a related entity, Duck Brothers, to First Options (J.A. 24-29); and
>
> 4) A "Subordinated Promissory Note" of MKI to First Options in the principal sum of $6,227,188 (J.A. 37-38).

The Guaranty and Subordinated Promissory Note were signed by MKI only. (J.A. 29 & 38.) The Subordinated Loan Agreement was signed by First Options, MKI and Duck Brothers. (J.A. 36.) Only the Subordinated Loan Agreement contained an arbitration clause. (J.A. 34-35.)

The Letter Agreement provided for certain specified prepayments in addition to setting forth detailed terms for repayment out of MKI's future trading profits. For instance, Mr.

Kaplan agreed to make an immediate prepayment of $80,000 to First Options, and MKI agreed to immediately transfer four Exchange seats to First Options. (J.A. 6-7.) In addition, it was agreed:

> 4. *Tax Refunds.* Mr. Kaplan and Mrs. Carol Kaplan ("Mrs. Kaplan"), his wife, shall file (or cause to be filed) all necessary documents to obtain all tax refunds . . . which are now, or which may be or become, due or owing to Mr. Kaplan and/or Mrs. Kaplan from the United States Government or any state or local government. Mr. Kaplan and Mrs. Kaplan will file (or cause to be filed) 1987 federal and state tax returns by June 15, 1988 and promptly deliver copies thereof to you [First Options]. . . . Upon receipt of any and all tax refunds, Mr. Kaplan and Mrs. Kaplan agree to immediately remit the amount of such refunds to you which shall be applied by you to the prepayment of the Total Indebtedness. (J.A. 7.)

This obligation to apply for and remit tax refunds was Mrs. Kaplan's *only* obligation under the Letter Agreement. (Pet. App. at A-8.) She received *no consideration* in exchange for this undertaking. Mrs. Kaplan's rather tangential role in the work-out is further confirmed by the following language in the Letter Agreement which specifically limits the effect of her signature:

> Mrs. Kaplan is signing this agreement to evidence her agreement to sign all documents necessary to fulfill the terms of this agreement applicable to her. (J.A. 20.)

Thus, the sum total of Mrs. Kaplan's voluntarily assumed obligations was to sign tax documents necessary to obtain refunds, and to remit the amount of those refunds to First Options. This obligation appears in a document, the Letter Agreement, which contains no arbitration clause, and which specifically limits Mrs. Kaplan's obligation to the signing of documents necessary to implement "the terms *of this agreement* applicable to her." Nowhere in this Letter Agreement is

there the slightest suggestion that Mrs. Kaplan agreed to arbitrate any disputes that might arise with respect to "the terms of this agreement applicable to her" or that she agreed to be bound by *any* terms of the Subordinated Loan Agreement.

The Arbitration Proceeding

Despite the absence of any agreement to arbitrate in the Letter Agreement, on July 1, 1989, after a further dispute arose between First Options and MKI, First Options instituted a Philadelphia Stock Exchange arbitration proceeding which, *inter alia*, sought judgment against Mrs. Kaplan, as well as against Mr. Kaplan, for the amount of their 1987 tax refunds. Mrs. Kaplan refused to sign any submission agreement (J.A. 54) and filed an objection to arbitral jurisdiction at the outset (J.A. 54-55). She also filed an answer which emphasized her marginal role in the work-out and the gratuitous nature of the obligation she undertook:

> [Mrs.] Kaplan admits that she signed the agreement referred to as the March 24, 1988 Agreement (the "Agreement") for the sole and limited purposes of Paragraph 4 relating to the Manuel Kaplan and Carol Kaplan 1987 income tax refund requests, and no other purpose. Her execution of the Agreement for that purpose was strictly as an accommodation. (R. 167)

On February 26, 1990, the attorney then representing both Mr. and Mrs. Kaplan in the arbitration proceeding participated in a discovery conference, having withdrawn the Kaplans' jurisdictional objections "from consideration *at the February 26, 1990 discovery conference*." (J.A. 55, emphasis added.) The discovery order which resulted from that conference made no mention of the jurisdictional issue. (*Id.*) From February 26, 1990 until December 1991, the arbitration proceeding was essentially dormant. (*Id.*)

On January 6, 1992, the Kaplans filed a motion and supporting memorandum seeking the dismissal of the claims against them for lack of jurisdiction. (*Id.*) On January 14, 1992, without waiting for a brief in opposition, the arbitration panel issued an

order stating simply that "[i]t is hereby determined and decided, *after full consideration*, that . . . Respondents' Motion to Dismiss for Lack of Jurisdiction, dated January 6, 1992, is hereby denied . . . ." (J.A. 39, emphasis added.) The arbitrators' decision, issued June 5, 1992, awarded First Options $346,342 (the amount of the Kaplans' 1987 joint federal tax refund) against Mr. and Mrs. Kaplan jointly and severally, with interest from January 17, 1989.[1]

The District Court's Ruling

On cross-petitions to vacate and confirm the arbitration award, the district court upheld the arbitrators' assertion of jurisdiction over Mr. and Mrs. Kaplan despite the fact that they were not parties to the Subordinated Loan Agreement:

> The Letter Agreement and the Subordinated Loan Agreement were executed in tandem, are inextricably intertwined and mutually dependent and must be read as a whole, particularly given the underlying circumstances and relationships of the parties. In view of this and the well-established federal policy favoring arbitration, the court concludes that pursuant to the arbitration provision in the subordinated loan document, the arbitration panel had jurisdiction over the Kaplans. (Pet. App. at C-14 - 15, citation omitted.)

The district court did not specify which "underlying circumstances and relationships" relevant to Mrs. Kaplan informed its application of the Subordinated Loan Agreement's arbitration provision to her, nor did the district court (which purported to carefully parse the various agreements, Pet. App. at C-13) address the provision which specifically limited the effect of Mrs. Kaplan's signature on the Letter Agreement to evidencing "her agreement to sign all documents necessary to fulfill

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1. The arbitrators also awarded First Options $5,662,188 against MKI and Mr. Kaplan jointly and severally, with interest from January 17, 1989. (J.A. 41-42.) Mr. Kaplan filed a voluntary petition for relief under the Bankruptcy Code on February 2, 1993.

the terms *of this agreement* applicable to her." Indeed, the district court appeared to perceive no distinction whatever between the rights and obligations of Mrs. Kaplan under the Letter Agreement, to the extent there were any, and those of any other party. (Pet. App. at C-11).

The district court also upheld arbitral jurisdiction on the alternative ground that the Kaplans had waived their jurisdictional objection by participating in the February 26, 1990 discovery conference and not thereafter reasserting the jurisdictional objection until January 1992. (Pet. App. at C-17 - 18.) The district court confirmed the arbitration award and entered judgment thereon. (Pet. App. at C-34 - 35.)

The Court of Appeals' Ruling

Exercising *de novo* review of the jurisdictional issue, the court of appeals observed that of the various bases for arbitral jurisdiction asserted by First Options, only the arbitration clause in the Subordinated Loan Agreement could potentially apply to Mrs. Kaplan. (Pet. App. at A-32, n.17.) The court of appeals found this argument unavailing as to either of the Kaplans:

> The circumstances of this case plainly negate the Kaplans' consent to arbitrate their individual responsibility for MKI's obligations. In the document they signed, they undertook only limited and precisely defined obligations. . . . They did not sign any documents that stated they would arbitrate their individual liability under the workout. (Pet. App. at A-26.)

The court of appeals also rejected the district court's holding that the Kaplans had waived their objections to arbitral jurisdiction:

> The Kaplans refused to sign any submission form. They asserted their objection to jurisdiction at the beginning of the arbitration proceedings. They reasserted it on the record before the arbitrators. Even if their former counsel withdrew the objections from

> consideration in order to participate in the discovery conference, neither that withdrawal or its scope is docketed or expressly noted in the arbitration record. Later, the Kaplans reasserted their objection in a motion to dismiss for lack of jurisdiction they filed in 1992, when the arbitration proceeding resumed. During the two years between the 1990 discovery conference and the Kaplans' reasserting of their objection, the case was dormant, without discovery, hearing, motion or ruling. (Pet. App. at A-18.)

Accordingly, the court of appeals reversed the order of the district court and remanded with instructions to enter in its place an order vacating the arbitrators' award against the Kaplans. First Options petitioned for certiorari on September 27, 1994. On September 29, 1994, while the petition for certiorari was pending, First Options commenced a separate action against Mrs. Kaplan in the district court, again seeking judgment in the amount of $346,342 on the basis of Paragraph 4 of the Letter Agreement (E.D. Pa. No. 94-5941). That case has been stayed pending the ruling of this Court, which granted certiorari on December 5, 1994.

SUMMARY OF ARGUMENT

Mrs. Kaplan adopts and incorporates by reference the arguments set forth in the Brief of Respondent Manuel Kaplan with respect to the issues on which certiorari was granted. Regardless of how that Court decides those issues, it may affirm the judgment of the court of appeals with respect to Mrs. Kaplan on the additional ground that even under a highly deferential standard of review, the arbitrators' assertion of jurisdiction over Mrs. Kaplan on the basis of an arbitration clause in an agreement to which she was not a party demonstrated an infidelity to their duty to construe and apply the agreements from which their powers purportedly derived, agreements which specifically negated any consent to arbitration by Mrs. Kaplan.

ARGUMENT

EVEN UNDER A DEFERENTIAL STANDARD OF REVIEW, THE ARBITRATORS' ASSERTION OF JURISDICTION OVER MRS. KAPLAN COULD NOT BE SUSTAINED.

Mrs. Kaplan adopts and incorporates by reference the arguments set forth in the Brief of Respondent Manuel Kaplan with respect to the degree of deference to be accorded to the arbitrators' jurisdictional determination and the appropriate standard of review to be applied by the court of appeals. Mrs. Kaplan did not "clearly and unmistakably" agree to be bound by the arbitrators' determination of their own jurisdiction. Moreover, the federal policies favoring enforcement of private arbitration agreements, efficient resolution of disputes, and judicial economy all support a rule that allows a party to argue jurisdictional objections to an arbitrator without waiving her rights to *de novo* judicial review of arbitrability. The rule urged by First Options, requiring immediate resort to the courts, will cause the judiciary to become mired in far more disputes over arbitrability than would be necessary if arbitration were allowed to take its course. And First Options' suggested "hybrid" standard or review — requiring courts of appeals to review district court confirmations of arbitration awards with greater deference than vacaturs — should be rejected as an unprincipled attempt to alter the institutional role of the courts of appeals to favor certain substantive outcomes. For these reasons, the court of appeals' judgment in Mrs. Kaplan's favor should be affirmed.

This Court, of course, may also affirm the judgment of the court of appeals "on any ground that the law and the record will permit and that will not expand the relief granted below." *Thigpen v. Roberts*, 468 U.S. 27, 29-30 (1984); *United States v. New York Telephone Co.*, 434 U.S. 159, 166 n.8 (1977). Regardless of how this Court rules with respect to the issues on which certiorari was granted, the judgment of the court of appeals in favor of Mrs. Kaplan should be affirmed because the arbitrators' assertion of jurisdiction over her cannot be sustained under *any* standard of review.

As Petitioner correctly points out, Pet. Br. at 21-22, this Court and others have variously formulated the special degree of deference to be accorded to certain arbitral decisions. An arbitral decision entitled to judicial deference cannot be overturned unless in "manifest disregard" of the law[2] or "not in any rational way . . . derived from the agreement."[3] It should be sustained "as long as the arbitrator is even arguably construing or applying the contract,"[4] or as long as it "draws its essence" from the contract.[5] Even under these rather undemanding standards, the court of appeals would rightly have vacated the arbitral award against Mrs. Kaplan because there simply was no basis for concluding that she consented to arbitrate *anything*.

It is a bedrock proposition that arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which she has not agreed to submit. *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. 643, 648 (1986). Although federal policy favors expansive coverage when the subject matter scope of an acknowledged arbitration agreement is in question, *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24-25 (1983), no such presumption in favor of arbitration applies to the question whether a party has entered into an agreement to arbitrate in the first place. *See Case International Co. v. T.L. James and Co.*, 907 F.2d 65, 67 (8th Cir. 1990); *McCarthy v. Azure*, 22 F.3d 351, 355 (1st Cir. 1994) ("The federal policy [favoring arbitration] presumes proof of a pre-existing agreement to arbitrate disputes arising between the protagonists. . . . [It] does not extend to situations in which the identity of the parties who have agreed to arbitrate is unclear.").

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2. *Wilko v. Swan*, 346 U.S. 427, 436 (1953).

3. *Ludwig Honold Manufacturing Co. v. Fletcher*, 405 F.2d 1123, 1128 (3d Cir. 1969).

4. *United Paperworkers International Union v. Misco, Inc.*, 484 U.S. 29, 38 (1987).

5. *United Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 596 (1960).

The existence *vel non* of an agreement binding a party to arbitrate, as opposed to its scope, must be determined by ordinary contract principles without reference to any policy favoring arbitration, as it is the judicial enforcement of extant agreements to arbitrate, not the creation of arbitration agreements as such, that the Federal Arbitration Act seeks to promote. *See Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987).[6] Because consent to arbitrate implies that the parties "consciously trade[d] the safeguards of full-fledged adjudication in the courts for the greater speed and lower costs of alternative dispute resolution," *National Wrecking Co. v. Teamsters Local No. 731*, 790 F. Supp. 785, 790 (N.D. Ill. 1992), consent to arbitration must be shown by a clear and specific agreement. *Case International Co.*, 907 F.2d at 67; *Par-Knit Mills, Inc. v. Stockbridge Fabrics Co.*, 636 F.2d 51, 54 (3d Cir. 1980).

Here the only evidence proffered that Mrs. Kaplan consented to arbitrate *any* dispute with First Options is the arbitration clause contained in the Subordinated Loan Agreement, to which Mrs. Kaplan was not a party. The arbitrators' summary denial of Mrs. Kaplan's jurisdictional objection (J.A. 39) gives no indication of how the arbitrators inferred her consent to arbitrate from this.[7] The district court's attempt to show that

6. Thus, the district court's reliance on "the well-established federal policy favoring arbitration," Pet. App. at C-13, as a factor in finding that Mrs. Kaplan had consented to arbitration, was misguided. The district court's confusion is further highlighted by its reliance on *Com-Tech Associates v. Computer Associates Int'l, Inc.*, 753 F. Supp. 1078 (E.D.N.Y. 1990), *aff'd on other grounds*, 938 F.2d 1574 (2d Cir. 1991). In that case there was no issue of enforcing an arbitration agreement against a non-party to the agreement. Rather, the only issue was the scope of the agreement, where it was undisputed that the parties had agreed to arbitrate.

7. It is clear, however, that the arbitrators did not deem the objection waived. Their decision stated that the objection was given "full consideration." Thus, the district court's alternative ground for affirming the assertion of jurisdiction over Mrs. Kaplan, waiver, flies in the face of the arbitrators' own actions. (In addition, in finding waiver, the district court found it "compelling" that Mr. Kaplan had filed a counterclaim. Pet. App. at C-17. Even if that had constituted a waiver by Mr. Kaplan, a view the court of appeals correctly rejected, it surely was not a waiver by Mrs. Kaplan.)

the arbitrators' decision could "rationally be derived" from the contract (Pet. App. at C-10), however, demonstrates just the opposite.

To hold Mrs. Kaplan to the arbitration clause in the Subordinated Loan Agreement, the district court relied, vaguely, on the "underlying circumstances and relationships of the parties." (Pet. App. at C-13.) Mrs. Kaplan's *only* relationship to any party to the Subordinated Loan Agreement was her status as the spouse of the principal of a corporate party, MKI. Needless to say, no rule of contract law, family law, corporation law or agency would permit a corporation to bind the wife of a stockholder to arbitration.

The other factor seemingly relied upon by the district court in its attempt to rationalize the assertion of jurisdiction over Mrs. Kaplan was her status as a signatory to the Letter Agreement, which was executed the same day as the Subordinated Loan Agreement and which cross-referenced it. The district court found the two agreements "inextricably intertwined and mutually dependent." Pet. App. at C-13. This observation can hardly be characterized as contractual construction, since it gives utterly no effect to the basic fact that separate agreements were signed — and instead effectively treats them as a single agreement — and it completely disregards the very limited and gratuitous nature of the obligation undertaken by Mrs. Kaplan in the Letter Agreement, *i.e.*, applying for and remitting tax refunds. Moreover, it gives no effect whatever to the plain language of the Letter Agreement which explicitly limited the effect of Mrs. Kaplan's signature to obligations found within the four corners of the Letter Agreement:

> Mrs. Kaplan is signing this agreement to evidence her agreement to sign all documents necessary to fulfill the terms *of this agreement* applicable to her. (J.A. 20, emphasis added.)

Thus, Mrs. Kaplan specifically negated any implication that she was consenting to *anything* other than her obligations under Paragraph 4 of the Letter Agreement, much less consent-

ing to forego her right to assert any defenses she might have — such as lack of consideration or duress — in a judicial forum. The assertion of arbitral jurisdiction over Mrs. Kaplan was not simply a "misinterpretation" of the Letter Agreement or the Subordinated Loan Agreement, it was a complete abdication of the arbitrators' obligation to construe the contracts at issue, rather than simply to dispense their own brand of justice.

As the court of appeals correctly observed:

> The circumstances of this case *plainly negate* the Kaplans' consent to arbitrate their individual responsibility for MKI's obligations. . . . There is *no ambiguity* about the absence of any consent to arbitrate in the documents the Kaplans signed individually. (Pet. App. at A-26 - 27, emphasis added.)

This finding justified vacatur of the award against Mrs. Kaplan under even the most deferential standard of review. Although the FAA insulates certain arbitral findings from searching judicial review to avoid "judicializing" the arbitration process, it does not absolve arbitrators of the duty to ground their actions in the words of the agreements from which they purportedly draw their powers. An arbitral award should be vacated "where an arbitrator 'manifest[s] and infidelity' to her obligation to interpret the contract, [or] ignores a plain and unambiguous provision of the contract." *Apex Fountain Sales, Inc. v. Kleinfeld*, 818 F.2d 1089, 1094 (3d Cir. 1987) (citations omitted).[8] Here the arbitrators failed to heed this obligation when they asserted jurisdiction over Mrs. Kaplan.

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8. *See also Georgia-Pacific Corp. v. Local 27, United Paperworkers Int'l Union*, 864 F.2d 940, 944 (1st Cir. 1988); *Leed Architectural Products, Inc. v. United Steelworkers, Local 6674*, 916 F.2d 63, 65 (2d Cir. 1990); *AP Parts Co. v UAW*, 923 F.2d 488, 491-92 (6th Cir. 1991); *Tootsie Roll Indus., Inc. v. Local Union 1, Bakery, Confectionery & Tobacco Workers Int'l Union*, 832 F.2d 81, 84 (7th Cir. 1987); *Inter-City Gas Corp. v. Boise Cascade Corp.*, 845 F.2d 184, 187 (8th Cir. 1988).

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1994

FIRST OPTIONS OF CHICAGO, INC., PETITIONER,

v.

MANUEL KAPLAN, CAROL KAPLAN & M.K. INVESTMENTS, INC., RESPONDENTS

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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---

REPLY BRIEF FOR THE PETITIONER

I. BECAUSE RESPONDENTS SUBMITTED THE ARBITRABILITY ISSUE TO THE ARBITRATORS, DISTRICT COURT REVIEW IS DEFERENTIAL

Respondents concede that an arbitrator's jurisdictional ruling is reviewed under a deferential standard if the parties have clearly and unmistakably "agree[d] to submit the jurisdictional issue to the arbitrator for conclusive determination." Resp. Br. 17 n.15; see *Warrior & Gulf*, 363 U.S. at

583 n.7.[1] Respondents acknowledge as well that they "filed a motion to dismiss for lack of jurisdiction" and a supporting memorandum of law with the Exchange's arbitration panel, requesting the panel to rule on their jurisdictional objections. Resp. Br. 7-8. None of respondents' efforts to avert the obvious conclusion—that because they asked the arbitration panel to decide the issue of arbitrability, they triggered the same deferential standard of judicial review that is applicable to arbitral decisions on other issues submitted to arbitration—can withstand scrutiny.

A. Respondents clearly submitted the arbitrability issue to the arbitration panel. The Kaplans assert that the parties did not clearly and unmistakably submit the issue of jurisdiction to the arbitrators. In an effort to suggest that they consistently denied the arbitration panel's authority to determine the jurisdictional issue, respondents repeatedly characterize their motion to dismiss as nothing more than an "objecti[on] to arbitrability" and "vigorous denial" of arbitral jurisdiction. Resp. Br. 17, 18; see also, *e.g.*, *id.* at 7-8. Respondents then urge this Court to distinguish between "objecting to arbitrability before the arbitrator" and "formal 'submission' [of the arbitrability] issue to binding arbitration," arguing that only in the latter case should the arbitrator's decision on arbitrability be accorded deference on judicial review. *Id.* at 17-18.

The underlying premise of respondents' argument—that they simply objected to jurisdiction but did not submit that issue to the arbitrators—is patently false. Respondents' motion to dismiss was not merely an objection to arbitral jurisdiction. To the contrary, the Kaplans fully briefed their jurisdictional objections and *asked* the panel to rule on that issue. Resp. Br. 7-8, 28; C.A. App. A194-A205. When the

[1] "Resp. Br." refers to the brief of Manuel Kaplan. "CK Br." refers to the brief of Carol Kaplan, which adopts Manuel Kaplan's arguments *in toto*. CK Br. 7.

panel, in response, determined that First Options' claims were arbitrable, the Kaplans fully participated in an eight day evidentiary hearing on the merits of First Options' claims and on the merits of the counterclaim filed by Manuel Kaplan that also invoked the panel's jurisdiction. Resp. Br. 28-29; Pet. App. A12. In those circumstances, the Kaplans clearly and unmistakably submitted arbitrability to the arbitrators for decision.

Respondents fail to identify any principled distinction between a *formal agreement* to submit arbitrability to the arbitrator—which they concede triggers deferential review—and the *actual submission* of arbitrability to the arbitrators. When the Kaplans asked the panel to rule on the grounds of jurisdiction over them that First Options had asserted (C.A. App. A194-A205), they defined arbitrability as one of "'the precise issues to be arbitrated'" as surely as if the parties had included that issue "in a submission agreement." Resp. Br. 17 & n.15. Cf. *Insurance Corp.* v. *Compagnie des Bauxites*, 456 U.S. 694, 706 (1982) ("By submitting to the jurisdiction of the court for the limited purpose of challenging jurisdiction, the defendant agrees to abide by that court's determination on the issue of jurisdiction"). The artificial distinction respondents advocate finds absolutely no support in this Court's precedents, which require only that agreement to arbitrate an issue be clear and unmistakable. See *AT&T Technologies*, 475 U.S. at 651; *Warrior & Gulf*, 363 U.S. at 583 n.7. Nor is it consistent with the design of the Federal Arbitration Act, which provides carefully structured opportunities to obtain judicial determination of arbitrability in the first instance.

B. Parties resisting arbitration have ample opportunity to secure judicial determinations of arbitrability. Amazingly, the Kaplans contend that the "common sense" response of a party "[un]willing to commit the jurisdictional question to the arbitrator for final decision" is to do just that: to present, brief and argue the jurisdictional point to the arbitration

panel. Resp. Br. 18. But the Arbitration Act and the body of law to which the Act was appended provide a coherent procedural scheme that enables a party resisting arbitration to have arbitrability determined in a judicial forum in the first instance; the Kaplans declined to make use of that procedure and instead asked for an arbitral ruling on jurisdiction. Having asked for and received an arbitral decision on arbitrability, the Kaplans would now remake the Act to give them yet another bite at the apple, inventing an entirely new method to obtain a *de novo* judicial determination of arbitrability.

A party resisting arbitration may refuse to arbitrate. That forces the other party to petition to compel arbitration under section 4 of the Act, or, if a judicial action has already begun, to petition under section 3 to stay that action pending arbitration. Respondents call it "Orwellian doublespeak" to suggest that defending against section 3 or 4 motions is a "procedural mechanism provided by the Act for parties objecting to arbitration." Resp. Br. 22. Leading commentators, however, recognize that this scheme provides a party that objects to arbitral jurisdiction with effective opportunities to obtain a judicial ruling on arbitrability in the first instance. 2 I. MacNeil, R. Speidel & T. Stipanowich, *Federal Arbitration Law* at 23:24 ("In both [section 3 and 4 proceedings], the party denying the obligation to arbitrate is a defender against the other party's motion or petition. Where the arbitration cannot go ahead without either the resisting party's cooperation or judicial intervention, *the opportunity to defend is generally all the judicial protection the resisting party needs*") (emphasis added).

Respondents maintain (Resp. Br. 14 n.13) that refusing to arbitrate was not an option for them because the Exchange's rules provide for a default award against a party that fails to appear. C.A. App. A296. But the Kaplans need not have awaited a default or the filing of a section 4 motion. They could instead have brought a declaratory or injunctive

action to stay the arbitration, thereby ensuring that a court would rule upon arbitrability in the first instance. Respondents do not deny that this course of action was available to them, or that they failed to seek a stay. Rather, they assert that nothing on the face of the Arbitration Act mandates that they should have taken "such extraordinary action." Resp. Br. 14; see *id.* at 21-22.

There can be no doubt, however, that a party's ability to seek a stay of arbitration and thereby obtain an initial judicial ruling on arbitrability is an integral and well-understood part of the Arbitration Act's architecture. "[T]o enjoin a party from arbitrating where an agreement to arbitrate is absent" is simply "the concomitant of the power to compel arbitration where it is present." *Societe Generale de Surveillance, S.A.* v. *Raytheon European Mgt. & Sys. Co.*, 643 F.2d 863, 868 (1st Cir. 1981) (Breyer, J.). The Act must be interpreted against the background of this "general judicial remed[y] for unjustified arbitral assertions of jurisdiction" (Resp. Br. 22 n.16), which derives from "the inherent equitable power of federal district courts to control their own docket." 2 I. MacNeil, R. Speidel & T. Stipanowich, *Federal Arbitration Law* at 23:26. Moreover, the Act itself confirms that stay-of-arbitration actions are a component of its goal of "guaranteeing the enforcement of private contractual arrangements." *Mitsubishi Motors*, 473 U.S. at 625. Section 16 of the Act, "by regulating appeals from decisions either enjoining or refusing to enjoin 'an arbitration that is subject to this title,'" explicitly "recognizes that such power exists apart from the [Act]." 2 *Federal Arbitration Law*, *supra*, at 23:26; see also 134 Cong. Rec. S16,309 (Oct. 14, 1988).[2]

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[2] Respondents' argument also ignores the historical context of the Arbitration Act. At the time Congress was considering the Act, parties resisting arbitration had no difficulty finding courts hostile to arbitration and willing to interfere with arbitration proceedings

In the alternative, had respondents simply refused to arbitrate they would not have presented their jurisdictional objection for arbitral determination and thus would have preserved that issue for judicial decision in the first instance. If a default award had been entered against them, the Kaplans could have presented the arbitrability issue to the court on judicial review of the award. Cf. *Insurance Corp.*, 456 U.S. at 706 ("A defendant is always free to ignore the judicial proceedings, risk a default judgment, and then challenge that judgment on jurisdictional grounds * * *").

In any event, it is by no means certain that First Options would have pressed ahead to obtain a default award if the Kaplans had declined to participate in arbitration. Even

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and to hear and decide contractual disputes even though they were subject to arbitration. Congress believed that the Act, coupled with the law already in place, provided both the parties seeking to enforce arbitration clauses and the parties claiming that disputes were not properly arbitrable the right to an advance determination of arbitrability:

> The bill declares simply that * * * agreements for arbitration shall be enforced, and provides a procedure in the Federal courts for their enforcement. The procedure is very simple * * * and at the same time safeguard[s] the rights of the parties. *There is provided a method for the summary trial of any claim that no arbitration agreement was ever made*, and there is also provided a hearing if the defeated party contends that the award was secured by fraud or other corruption or undue influence, or that some evident mistake not affecting the merits exists in the award. If the parties to the arbitration are willing to proceed under it, they need not resort to the courts at all. *If one party is recalcitrant he can no longer escape his agreement, but his rights are amply protected.*

H.R. Rep. No. 96, 68th Cong., 1st Sess. 1, 2 (1924) (emphases added).

where the arbitration agreement includes a default provision, a party faced with a recalcitrant opponent seeking to avoid arbitration may well file a section 4 motion to obtain an early decision on the proper forum for the dispute. The section 4 procedure is designed to be "as quic[k] and eas[y] as possible" and a party will often prefer to use that procedure rather than win a default award that may be of little value until its jurisdictional basis is tested on judicial review. *Moses H. Cone Mem. Hosp.*, 460 U.S. at 22.

Respondents took none of the options open to them to obtain a judicial determination of arbitrability, but instead presented the jurisdictional issue to the arbitration panel. They pretend that First Options somehow forced them to take this action by failing to "as[k] the federal district court to compel arbitration." Resp. Br. 19-20. This unexplained assertion is absurd. The section 4 "remedy for a party 'aggrieved by [a refusal to arbitrate]'" was unavailable to First Options because the Kaplans did not refuse to arbitrate. *Prima Paints*, 388 U.S. at 400. Far from it: respondents waived, at a discovery conference, the jurisdictional objections they had initially asserted (J.A. 55 ¶ 5), subsequently moved the arbitration panel to rule on arbitrability and, when they lost that motion, proceeded to arbitrate the merits. First Options had no reason to petition to compel arbitration and every reason to believe that the predicate for a section 4 petition had not been satisfied. Nor was section 3 of the Act implicated, because First Options had no need to stay any litigation pending an arbitration.[3]

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[3] Respondents insinuate that First Options filed its arbitration claim "to gain a home-court advantage before a favorably predisposed" panel. Resp. Br. 20. But MKI and Manuel Kaplan were Philadelphia-based members of the Philadelphia Stock Exchange, and respondents point to no evidence whatsoever that the panel was predisposed to favor Chicago-based First Options. See Pet. App. A4-A5. Indeed, the panel originally included a business associate

Because First Options had no need to file a section 3 or 4 petition so long as the Kaplans were proceeding with the arbitration, this was a case in which the party wishing to avoid arbitration and to have a court decide arbitrability in the first instance should either have refused to arbitrate or have "take[n] the offensive" by filing an action to stay the arbitration. 2 I. MacNeil, R. Speidel & T. Stipanowich, *Federal Arbitration Law* at 23:24. The Kaplans did neither, but instead presented the arbitrability issue to the Exchange's arbitration panel for decision.[4] When a party chooses to

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and friend of Manuel Kaplan's, Michael Waber, who was removed when First Options objected to his participation. C.A. App. A316, A569, A574. The district court firmly rejected respondents' claim of arbitral bias. Pet. App. C18-C26.

[4] Perhaps, as the Ninth Circuit holds, respondents could also have preserved arbitrability for *de novo* judicial review by expressly refusing to give that issue to the arbitrators. *George Day*, 722 F.2d at 1476; *Van Waters & Rogers, Inc.* v. *International Bhd. of Teamsters, Local No. 70*, 913 F.2d 736, 740 (9th Cir. 1990). The Kaplans did not do so—quite the opposite—so the Court need not decide whether that option exists (and petitioner certainly does not advocate or "suggest" its recognition). Respondents' head-scratching about "how * * * a party could keep an arbitrator [from] address[ing] jurisdictional objections" is misplaced (Resp. Br. 26), for *Van Waters* illustrates that a party may readily impose an express restriction on the scope of arbitration; an arbitrator's choice to ignore that restriction would not deprive the party of *de novo* review, because it did not agree to submit jurisdiction for arbitral determination. Respondents' second criticism of a rule allowing a party to preserve arbitrability for *de novo* review by refusing to give the question to the arbitrator—that "[i]t would require arbitrators to proceed blindly with arbitrations despite the existence of unexamined jurisdictional objections" (*id.* at 15)—has more substance and suggests that to obtain an initial judicial ruling on arbitrability a party should be required to follow the affirmative procedures discussed in text.

submit arbitrability to the arbitrator in this way, any subsequent judicial challenge to arbitral jurisdiction is narrowly constrained by section 10 of the Act. Section 10 requires extremely deferential review, permitting a court to overturn only those arbitral rulings that are in "manifest disregard of law." See Pet. Br. 20-23.

Respondents protest it would be "unfair" to apply section 10's manifest disregard standard to them—although they *asked* the arbitrators to rule on arbitrability—because "settled" Third Circuit law did not mandate that they seek a stay or refuse to arbitrate to preserve their jurisdictional argument for *de novo* review. Resp. Br. 28-29. But Third Circuit law did recognize that "[i]f the parties submit the issue of arbitrability to the arbitrator" a court must give the arbitrability decision "the same deference due an arbitrator's decision on the merits." *United Indus. Workers*, 987 F.2d at 167. Moreover, the rule we advocate is hardly "new," but flows from this Court's precedents and has been followed in other circuits. Pet. Br. 14-16, 27-30. In any event, the "general rule" that "the law announced in the Court's decision controls the case at bar" is particularly appropriate in cases that enforce arbitration agreements and thereby "furthe[r] the purposes and effect of the Arbitration Act." *Rodriguez de Quijas*, 490 U.S. at 485.[5]

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[5] Respondents' *amicus* suggests, without citing authority, that *de novo* review of arbitrability decisions submitted to arbitrators for decision would harmonize federal law with the Uniform Arbitration Act in force in many states. SIA Am. Br. 9. In fact, state courts have routinely held that, in those circumstances, the Uniform Act does not permit *de novo* review of the jurisdictional issue and that a party objecting to arbitrability must seek a stay. *E.g.*, *Boyte* v. *Dickson*, 303 S.E.2d 418, 420-421 (N.C. Ct. App. 1983); *Jaffe* v. *Nocera*, 493 A.2d 1003, 1010 n.9 (D.C. Ct. App. 1985) (listing Uniform Act cases holding "that a failure to raise the issue of arbitrability by way of an application for stay of arbitration together with participation in the arbitration proceedings will

C. The Third Circuit's decision undermines the federal policies served by the Arbitration Act. Earlier this Term, in *Allied-Bruce Terminix Cos.* v. *Dobson*, No. 93-1001, slip. op. at 4 (Jan. 18, 1995), this Court reaffirmed the strong federal policy favoring enforcement of agreements to arbitrate. That policy is best served by the procedures contemplated in the Arbitration Act. On the one hand, a party opposing arbitration and desiring to obtain a judicial ruling on arbitrability in the first instance may bring an independent action for injunctive or declaratory relief; alternatively, it may refuse to arbitrate, then either defend against a section 3 or section 4 motion or, if a default is entered, seek *de novo* judicial review of arbitral jurisdiction. On the other hand, a party may choose to take advantage of the efficiency and economy of arbitration by presenting the issue of arbitrability to the arbitrator for decision in the first instance, as respondents did here. In that case, the arbitrator's rulings on jurisdiction and the merits are both reviewed under the deferential "manifest disregard" standard, in accordance with section 10. As we explained in our opening brief (Pet. Br. 23-27), this scheme promotes the speed and finality of arbitration and conserves the resources of parties, arbitrators, and federal courts alike by avoiding *de novo* relitigation of issues voluntarily submitted to arbitral decision.

Respondents' efforts to cast doubt on the practical benefits of denying *de novo* review in their situation are uniformly unsuccessful. We agree with respondents (Resp. Br. 23) that a lack of meaningful judicial review of arbitrability would be a disincentive to enter into arbitration agreements. But it is indisputable that in defending section 3 or 4 motions or seeking a stay of arbitration a party has every opportunity to have a court rule upon arbitrability in the first

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waive the arbitrability issue and foreclose a party from raising it in a petition to vacate the award").

instance. And when parties instead agree to submit arbitrability to the arbitrator, a court will upset an arbitral ruling on jurisdiction if it is manifestly irrational. See CK Br. 9. No more is necessary to encourage arbitration agreements.

Nor is it inefficient to require a party to obtain any *de novo* judicial resolution of arbitrability prior to the arbitration proceeding, as respondents imagine. Resp. Br. at 23-26. An early and quick judicial determination as to the proper forum for a dispute—fostered by the simplified procedure provided for in section 6 of the Act—maximizes efficiency. If the objector prevails, the parties and arbitrators are saved the time and expense of conducting an arbitration. If the objector loses, the court's ruling provides substantial certainty that the arbitration will be binding.

The short delay that results from seeking an initial judicial determination of arbitrability (see Resp. Br. 25) pales in comparison to the waste involved in allowing a party to litigate jurisdiction twice, once before the arbitrator and then again before the court. Moreover, in order to take advantage of the greater speed, economy, and informality of the arbitral process, parties will often agree to present the jurisdictional issue to the arbitrator rather than seek a judicial ruling—as respondents did here and as parties typically have done in those circuits that already recognize the rule that the Third Circuit rejected. Pet. Br. 27-30. A party should not be permitted to renege on that decision by seeking *de novo* judicial review if it does not like the result of the arbitration. Respondents identify no reason why they should get two bites at the apple in that way. See *Allied-Bruce Terminix*, slip. op. at 12 (rejecting an interpretation of the Act "that risks the very kind of costs and delay through litigation * * * that Congress wrote the Act to help the parties avoid"). Far from allowing "the entire controversy to be resolved by the arbitral process" (Resp. Br. 24), the Third Circuit's rule

would effectively make an arbitrator's (invited) ruling on jurisdiction futile and a nullity.[6]

Respondents suggest that this Court should not concern itself with inefficiencies generated by the decision below, purporting to find an analogy in the usual federal rule that jurisdictional decisions by district courts are reviewed *de novo* after final judgment. Resp. Br. 19, 24 n.19, 27. This comparison is inapt, for it takes no account of the special arbitration context. The Arbitration Act sets out *sui generis* standards and procedures intended to make arbitration rapid, inexpensive, and substantially final, and so to encourage the diversion of disputes to the arbitral arena. Allowing a litigant to present arbitrability to the arbitrator for decision and, upon losing, to present arbitrability to the district court *de novo* would seriously undermine those statutory goals, which have no parallel in the relationship of the federal district courts and courts of appeals.

The purposes Congress intended the Arbitration Act to serve, as well as the language and structure of the Act, show that the parties' decision to submit the jurisdictional issue to the arbitrator should be given effect. The Third Circuit therefore erred when it held that the arbitrators' jurisdictional decision is to be reviewed *de novo*, rather than for manifest disregard of law.

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[6] Because parties will often submit arbitrability to the arbitrator in lieu of seeking a judicial ruling in the first instance, it is not true that "the federal courts [would] become involved [through section 3 or 4 or stay proceedings] every time a jurisdictional objection were raised." Resp. Br. 26. In addition, as respondents admit, a "deferential standard [of judicial review of jurisdictional questions submitted to the arbitrator] would discourage some objecting parties from pursuing the jurisdictional issue in the courts" in section 10 proceedings. *Id.* at 25 n.20.

II. UNDER ANY STANDARD OF REVIEW, THE ARBITRATORS' JURISDICTIONAL RULING SHOULD BE AFFIRMED

The district court, while it ruled that "manifest disregard of law" is the correct standard of review, also applied the *de novo* standard in the alternative. After carefully considering the arbitration record, the district court "conclude[d] that even under a *de novo* review, the panel properly exercised jurisdiction" over the Kaplans. Pet. App. C18. Respondents have supplied no persuasive reason to upset that determination, still less to doubt that the arbitrators' jurisdictional decision failed the manifest disregard standard.

Respondents claim that the award against them should not stand because they "never signed any document containing an arbitration agreement." Resp. Br. 30; see also CK Br. 8-12. The district court, however, held that the Kaplans were bound by the arbitration clause in the Subordinated Loan Agreement because they had signed the Letter Agreement and because "[t]he Letter Agreement and the Subordinated Loan Agreement were executed in tandem, are inextricably intertwined and mutually dependent and must be read as a whole, particularly given the underlying circumstances and relationships of the parties" (Pet. App. C13)—circumstances that included Manuel Kaplan's frequent disregard of MKI's separate corporate existence. See *id.* at C28-C30.

Moreover, despite respondents' myopic focus on the alleged lack of an arbitration agreement, the district court held that Manuel Kaplan was bound by the arbitration result for two additional, compelling reasons. First, the court held that Mr. Kaplan's failure to separate his own affairs from those of MKI provided an independent ground for the exercise of arbitral jurisdiction. The court found that there was "ample support in the record for the arbitrators' decision to pierce the corporate veil" between Manuel Kaplan and MKI, and so to exert jurisdiction over Manuel Kaplan through their undisputed jurisdiction over the corporation.

Pet. App. C30. The evidentiary support for piercing the corporate veil included "considerable testimony regarding the commingling of Mr. Kaplan's personal funds with those of MKI" and evidence that Mr. Kaplan otherwise "disregarded corporate formalities and siphoned corporate funds." *Id.* at C28-C29. Those actions involved not only Mr. Kaplan's withdrawal of $611,000 from MKI in the weeks following the October 1987 crash,[7] but also a consistent pattern of commingling corporate and personal funds and treating MKI's assets as his own—including drawing MKI funds to use in buying a house and to pay his personal tax bills. Pet. App. C28-C29. There was evidence that between February 1986 and January 1989 "Manuel Kaplan removed from [MKI's] corporate account and used for personal purposes * * * a total of $4.5 million." *Id.* at C29.

The district court also held that the arbitrators had jurisdiction because the Kaplans *waived* their jurisdictional objections at a discovery conference and then waited two years to try to reassert those objections. The court held that this delay had been too long and that the objections had been lost as a result. Pet. App. C17 ("A party reasonably cannot 'reverse course' about an arbitration panel's jurisdiction once the arbitration has commenced and matters pertinent to the arbitration have been litigated and ruled upon"). This Court has made clear that in determining whether a "'defense to arbitrability'" has been waived or lost through delay—just as in "'constru[ing] the contract language itself'"—the Arbitration Act requires that "'any doubts concerning [arbitrability] should be resolved in favor of arbitration.'" *Mastrobuono* v.

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[7] The bankruptcy court finding that respondents cite in connection with Mr. Kaplan's withdrawal of $611,000 from MKI is being contested in the district court. Resp. Br. 3 n.4. In the arbitration there was evidence that Kaplan used those funds to pay personal debts and none that he used them to pay MKI creditors. See C.A. App. A1049-A1051, A1234, A1240-A1242.

Shearson Lehman Hutton, Inc., No. 94-18, slip op. at 10 n.8 (March 6, 1995) (quoting *Moses H. Cone*, 460 U.S. at 24-25). Thus, even if respondents were correct in their assertion that the arbitration agreement did not apply to the Kaplans individually (which they are not), jurisdiction was properly exercised over both Manuel and Carol Kaplan on this waiver ground as well.[8]

III. THE THIRD CIRCUIT EXERCISED DE NOVO APPELLATE REVIEW IN CONFLICT WITH THE PRO-ARBITRATION POLICY OF THE ACT

The federal policy of promoting arbitration of private disputes is firmly embedded in the Arbitration Act, including section 16, which links the appealability of district court orders to the outcome of the district court decision as to arbitrability. See Pet. Br. 34-36. The explicit distinction drawn in section 16 is much too substantive to be, as respondents contend (Resp. Br. 36), a matter of mere

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[8] The district court determined that, under any standard of review, Carol Kaplan was subject to arbitral jurisdiction on two distinct grounds. First, she had signed the Letter Agreement, obligating her to remit the Kaplans' tax refund check to First Options and, under all the circumstances of the case, had agreed to abide by the arbitration clause in the Subordinated Loan Agreement, which specifically provided for the arbitration of "any controversy arising out of or relating to * * * the Letter Agreement." J.A. 34. Second, she had waived her jurisdictional objections to arbitration at the discovery conference and left it too late to try to revive those objections. Respondents suggest that because the arbitration panel said its denial of respondents' motion to dismiss was rendered "after full consideration," it ruled solely on the merits and did not rest its jurisdiction on waiver. Resp. Br. 8 n.8; CK Br. 10 n.7. Respondents argued to the arbitration panel, however, that they had not waived objections to arbitral jurisdiction. C.A. App. A202, A204. "Full consideration" by the panel therefore obviously included consideration of the waiver ground for jurisdiction.

"timing." Moreover, promotion of arbitration over litigation is the repeated theme running through the legislative history of the Act and its amendments, and is stressed again and again in this Court's precedents.

In light of this policy, it would be odd indeed if a standard of appellate review were adopted that encouraged resort to the courts whenever a party was unhappy with the determination of a jurisdictional issue submitted to the arbitrator. Yet, that is the predictable effect of the *de novo* appellate standard urged by respondents. It would give the party disputing jurisdiction a chance to have the arbitrator rule in its favor, then to get a fresh attempt in the district court, and then to procure yet another opportunity in the court of appeals—encouraging disrespect for arbitral finality and undermining the speed, efficiency, and cost advantages of arbitration.[9]

Respondents contend that *de novo* review would promote "predictability and consistency of outcome." Resp. Br. 36. But "doctrinal uniformity" (*id.* at 33) has never been an objective of the arbitration process: "arbitration seeks particularized justice rather than to foster substantive consistency and predictable results for the future." 1 I. Macneil, R. Speidel, & T. Stipanowich, *Federal Arbitration Law* at 2:40; see also Pet. Br. 24-25. Respondents' desire for uniformity is not achievable in a forum in which written opinions are

[9] Respondents' contention that *de novo* review would be as speedy as more deferential review (Resp. Br. 35) is wrong and misses the point. It is wrong because a court of appeals applying *de novo* review would be unable to stand on the shoulders of the district court and rely on its work, but, like the court of appeals here, would have to comb through the entire record anew. More important, *de novo* review would provide the losing party in district court a greater incentive to appeal than would a deferential standard, encouraging appeals and delaying final resolution of the dispute.

rarely issued and even more rarely published. Respondents, having submitted their dispute to the arbitrators and lost, now seek the full panoply of appellate protections. But to grant their wish would defeat the very rationale for arbitration as an efficient substitute for litigation.

A. The Eleventh Circuit's hybrid standard of review conforms to the pro-arbitration policy of the Act. The Eleventh Circuit's hybrid standard of review for determinations of arbitrability appropriately implements federal policy. It takes a hard look at rejections of arbitrability and a light look at confirmations of arbitrability. This standard tracks the differential treatment accorded confirmation and vacation of arbitrability determinations in section 16 of the Arbitration Act. It thus renders the role of the appellate court compatible with the pro-arbitrability policy directed by Congress.

Respondents find it unseemly to have standards of review reflect "substantive policies." Resp. Br. 33. They argue that a "'bifurcated' standar[d] depending on the outcome below" is found in "no other area of law." *Id.* at 34. In fact, such bifurcation is found in numerous areas of law. For example, courts of appeals give greater deference to district courts' denials of new trial motions after jury trials than to grants of such motions. *E.g.*, *Koonce* v. *Quaker Safety Prods. & Mfg. Co.*, 798 F.2d 700, 718 (5th Cir. 1986); see also 1 S. Childress & M. Davis, *Federal Standards of Review* 5-82 (2d ed. 1992). Appellate courts review denials of leave to amend pleadings more strictly than grants. *E.g.*, *Mayes* v. *Leipziger*, 729 F.2d 605, 608 (9th Cir. 1984). Hybrid standards are also often applied to discovery decisions and involuntary dismissals. 1 *Federal Standards of Review*, *supra*, at 4-154. These hybrid standards reflect substantive policies against overriding juries and involuntary dismissal and in favor of liberal amendment of pleadings and liberal discovery. Similarly, the Eleventh Circuit's hybrid standard of review accommodates the substantive federal policy in favor of arbitration of private disputes.

Respondents also complain that in other areas of law courts of appeals do not defer to district courts' review of "another entity's" decision. Resp. Br. 34-35. However, the "entities" respondents point to are all courts or government agencies, not, like arbitrators, third parties hired by the parties and by whose rulings the parties are contractually bound. This private contractual context, and Congress' decision in the Arbitration Act to protect and promote arbitration agreements and to minimize judicial intervention, readily distinguish this case from the situations respondents identify.[10]

B. If the court of appeals had applied ordinary standards of review, it would have affirmed the district court. If the standard of appellate review ordinarily applicable to factual findings were to be applied it would still require confirmation of the arbitrator's award. Though the court of appeals paid lip-service to the clearly-erroneous standard for review of factual findings (Pet. App. A15), it then engaged in a lengthy review of the evidence that gave absolutely no

[10] Respondents claim that a bifurcated appellate standard would breed "confusion" whenever the district court partially vacated or modified an arbitration award. Resp. Br. 36 n.32. But courts of appeals have long experience handling differing standards for reviewing factual and legal determinations in the same case. See also, *e.g.*, *United States* v. *Guardino*, 972 F.2d 682, 686 (6th Cir. 1992) (restitution order under Victim and Witness Protection Act is subject to "bifurcated" standard of review—*de novo* for legality of order and abuse of discretion for amount ordered); *Massachusetts* v. *United States*, 788 F. Supp. 1267, 1270 (D. Mass. 1992) (describing First Circuit's "bifurcated standard of review in food stamp cases, applying a *de novo* standard to the determination of the violation and a limited administrative review standard to the sanction imposed").

deference to the district court's critical factual determinations.[11]

Respondents suggest (Resp. Br. 37) that there were no relevant factual disputes in this case because the parties filed factual stipulations—an extraordinary contention given the extent to which respondents argue facts in their brief. To be sure, some facts were stipulated by the parties—most notably respondents' waiver of jurisdictional objections at the discovery conference. J.A. 55. But that stipulation left an open question about respondents' intentions in making the waiver. And none of the stipulations concerned other facts upon which the district court's decision explicitly rested. For example, the parties' stipulations did not address "the underlying circumstances and relationships of the parties," which informed the district court's interpretation of the parties' intentions in entering into the Workout Agreement. Pet. App. C13. Nor did the stipulations cover the factual basis for the court's conclusion that arbitral jurisdiction was proper on a piercing-the-corporate-veil theory. That ruling was based upon evidence in the arbitration record that Manuel Kaplan commingled his funds with MKI's, ignored MKI's corporate form, and used MKI's assets as his own. *Id.* at C28-29. Because the district court's review of arbitral jurisdiction was therefore largely fact-bound, the court's ruling was entitled to substantial deference.

[11] Respondents' contention that the court of appeals' misapplication of ordinary standards of review "should not be considered" by this Court lacks merit. Resp. Br. 37. The second question on which certiorari was granted explicitly raises the application of the *de novo* and abuse of discretion standards. Also, the appropriate application of ordinary standards of review is before this Court because the issue is "fairly subsumed" in the granted questions and has been briefed by both parties. *Oklahoma Tax Comm'n* v. *Citizen Band Potawatomi Indian Tribe*, 498 U.S. 505, 512 (1991).

Even in its review of conclusions of law, the court of appeals erred. Independent review by a court of appeals means that it should stand in the shoes of the district court, applying the same "manifest disregard" standard that governs the district court's review of the arbitrators' award. See Pet. Br. 38-39. Only in that way does a court of appeals accord due respect to "the only decision-maker arguably entitled to deference—the arbitrator." *Mastrobuono*, slip op. at 8 n.4. Instead, the Third Circuit rejected the manifest disregard standard and reviewed *de novo* all the bases of both the arbitrators' and the district court's decisions, repeating the work already done by two other tribunals. This replication of effort destroyed the benefits of arbitration, causing greater burdens than would have been associated with litigation, and cannot conceivably be the correct approach.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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In The

Supreme Court of the United States

October Term, 1994

FIRST OPTIONS OF CHICAGO, INC.,

Petitioner,

v.

MANUEL KAPLAN, CAROL KAPLAN and MK INVESTMENTS, INC.,

Respondents.

On Writ of Certiorari To The United States Court Of Appeals For The Third Circuit

BRIEF OF *AMICI CURIAE* NATIONAL FUTURES ASSOCIATION, CHICAGO BOARD OF TRADE, AND CHICAGO MERCANTILE EXCHANGE IN SUPPORT OF PETITIONER

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I. STATEMENT OF INTEREST OF *AMICI CURIAE*

The Commodity Exchange Act, 7 U.S.C. §§ 1-22 (1994) – like the Securities Exchange Act of 1934 ("Securities Exchange Act"), 15 U.S.C. §§ 78a-78kk (1994) in connection with the regulation of the securities industry – sets forth a comprehensive system for the federal regulation of the commodity futures industry. *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 355 (1982).

The Chicago Board of Trade ("CBOT") and the Chicago Mercantile Exchange ("CME"), which are futures exchanges, and National Futures Association ("NFA"), which is a registered futures association, are self-regulatory organizations ("SROs") authorized under the Commodity Exchange Act to resolve futures-related disputes through arbitration. *See* 7 U.S.C. § 7a(11) (1994) and 7 U.S.C. § 21(b)(10) (1994). In fact, futures SROs are required by law to arbitrate certain claims. *See Geldermann, Inc. v. Commodity Futures Trading Commission*, 836 F.2d 310 (7th Cir. 1987), *cert. denied*, 488 U.S. 816 (1988). Rules promulgated by the CBOT, the CME, and NFA must be submitted to the Commodity Futures Trading Commission ("CFTC") for approval pursuant to Sections 5 and 17, respectively, of the Commodity Exchange Act (7 U.S.C. § 7a(12) (1994); 7 U.S.C. § 21(j) (1994)) and must meet the standards set by CFTC Regulations §§ 180.1-180.5 (17 C.F.R. §§ 180.1-180.5 (1994)).

The arbitration forums administered by the CBOT, the CME, and NFA are very similar to the one at the Philadelphia Stock Exchange which was utilized by the parties in this case. The U.S. Supreme Court's holding in

this case would almost certainly be applied to arbitration cases filed with the futures SROs participating in this brief. Therefore, the CBOT, the CME, and NFA have a substantial interest in the outcome of the issues which the Court has chosen to review in this case.

The parties have consented to the filing of this *Amicus Curiae* brief by the CBOT, the CME, and NFA. Copies of the consent letters have been filed with the Clerk of the Court.

II. SUMMARY OF ARGUMENT

The CBOT, the CME, and NFA are filing this *Amicus Curiae* Brief in support of Petitioner, First Options of Chicago, Inc. These arbitration forums submit that the same deferential standard of review should apply to all issues actually submitted by the parties to the arbitrators for decision. Any less deferential standard is contrary to the intent of the Federal Arbitration Act (9 U.S.C. §§ 1-16 (1994)) and the national policy favoring arbitration of commodity futures and securities disputes.

Failure to apply a deferential standard of review to arbitrability issues submitted to and decided by the arbitrators could discourage arbitrators from serving and have other far-reaching effects on securities and commodity futures arbitration proceedings. Failure to apply a deferential standard of review will also encourage post-arbitration litigation and greatly reduce the advantages of arbitration, forcing claimants to either file their claims in court or forgo them altogether.

III. ARGUMENT

WHERE THE PARTY OBJECTING TO ARBITRAL JURISDICTION HAD SUBMITTED THE ISSUE TO THE ARBITRATORS FOR DECISION, A COURT REVIEWING THE ARBITRATION AWARD UNDER THE FEDERAL ARBITRATION ACT SHOULD APPLY THE SAME DEFERENTIAL STANDARD OF REVIEW TO THE ARBITRATORS' DECISION ON ARBITRABILITY THAT IT APPLIES TO THE ARBITRATORS' DECISION ON THE MERITS.

Amici have filed this brief to address a very narrow issue. This brief does *not* address the standard of review to be applied where the party challenging the arbitrators' jurisdiction did not submit that issue to the arbitrators for determination and participated in the arbitration proceeding only under protest. However, where the issue of arbitrability has been submitted to the arbitrators by the person challenging the arbitrators' jurisdiction over him, the arbitrators' decision should be subject to the same deferential standard of review that courts apply to the arbitrators' decision on the merits.

A. Failure to Apply a Deferential Standard of Review Could Discourage Arbitrators from Serving on Arbitration Panels and Have Other Far-Reaching Effects on Securities and Commodity Futures Arbitration Proceedings.

The *de novo* standard of review applied by the Third Circuit Court of Appeals allows courts to disregard the determinations of arbitrators on the arbitrability issue even where the parties had submitted the arbitrability

issue to the arbitrators for resolution. If this standard is upheld, a party who is unhappy with the result of the arbitration can get a second bite of the apple in court – relegating the arbitration award to an inferior status and wasting the often substantial time and energy expended by the arbitrators.

The typical arbitrator in an arbitration administered by a securities or futures SRO is a full-time lawyer or industry professional who serves with little or no compensation for the benefit of the industry and the investing public. These arbitrators are regularly called upon to resolve jurisdictional or arbitrability issues, and they devote substantial time and effort to the resolution of these issues. Where arbitrators resolve the jurisdictional issues in a case in favor of arbitrability, they continue to devote substantial time and effort to deciding the merits of the case.

If the reviewing court applies a *de novo* standard of review under these circumstances, the voluntary efforts of these skilled individuals to adjudicate arbitrability issues, which often involve questions of fact as well as law, will be fruitless. Substantial resources will be wasted, arbitrators will be deterred from serving on arbitration panels, and the arbitration process as a whole will be weakened. This result is contrary to the securities and commodity futures regulatory framework and to the liberal federal policy in favor of arbitration.

The resources expended on these cases is not limited to the arbitrators' time but includes the time and money spent by the parties and the arbitration forum on administering the arbitral process, providing a hearing facility,

procuring the attendance of witnesses, and hiring legal counsel. The potential waste of these resources and the increased difficulty in attracting the most qualified arbitrators could undermine the comprehensive arbitration systems currently in place in the securities and commodity futures industries, with far-reaching consequences.

Arbitration has become a common method for resolving disputes in the futures and securities industries. Over the five-year period from 1990 through 1994, the CBOT, the CME, and NFA alone received over 1,700 arbitration claims and disposed of over 2,000 cases, as follows:

Year	Entity	Total Cases Received	Total Cases Concluded
1990	CBOT	53	53
	CME	95	82
	NFA	278	454
1991	CBOT	50	49
	CME	90	81
	NFA	232	287
1992	CBOT	32	30
	CME	86	100
	NFA	200	303
1993	CBOT	69	44
	CME	60	76
	NFA	191	180
1994	CBOT	28	38
	CME	61	60
	NFA	189	180
TOTAL		1,714	2,017

The numbers in the securities industry are even more striking. Published information on arbitration cases at the seven largest securities industry SROs shows 24,229 cases filed and 24,261 cases concluded in the four year period of 1990-1993.

Year	Total Cases Received	Total Cases Concluded
American Stock Exchange		
1990	69	72
1991	51	64
1992	45	55
1993	48	55
Chicago Board Options Exhange		
1990	67	85
1991	46	62
1992	28	28
1993	15	18
Municipal Securities Rulemaking Board		
1990	75	90
1991	94	82
1992	45	68
1993	30	47

Year	Total Cases Received	Total Cases Concluded
National Association of Securities Dealers		
1990	3,617	4,019
1991	4,150	4,037
1992	4,379	4, 375
1993	5,419	4,327
New York Stock Exchange		
1990	1,378	1,466
1991	1,403	1,497
1992	873	1,167
1993	809	837
Pacific Stock Exchange		
1990	93	68
1991	86	82
1992	58	65
1993	199	54
Philadelphia Stock Exchange		
1990	29	34
1991	33	32
1992	21	18
1993	40	24

Year	Total Cases Received	Total Cases Concluded
	Total	
1990	5,701	6,423
1991	6,231	6,287
1992	5,737	6,189
1993	6,560	5,362

Source: 6 SECURITIES ARBITRATION COMMENTATOR, Oct. 1994, at 15; 5 SECURITIES ARBITRATION COMMENTATOR, Sept. 1993, at 9.

Similarly, the American Arbitration Association ("AAA") reports that 577 securities arbitration claims were filed there in 1991, 485 in 1992, and 635 in 1993. This is only a fraction of its overall filings, which totaled 63,171 in 1993. DISPUTE RESOLUTION JOURNAL, June 1994, at 5; ARBITRATION JOURNAL, March 1992, at 4. In fact, the claims and counterclaims in the 12,713 commercial cases filed at AAA in 1993 totaled over six billion dollars. Brief of American Arbitration Association as *Amicus Curiae* in Support of Petitioners, at Appendix, *Allied-Bruce Terminix Companies, Inc. v. Dobson*, 628 So. 2d 354 (Ala. 1993), *cert. granted*, ___ U.S. ___, 114 S. Ct. 1292 (1994) (No. 93-1001) (brief filed with the U.S. Supreme Court on May 18, 1994). *All* of these cases, as well as the thousands of other arbitration cases filed in other arbitration forums each year, are potentially affected by the standard of review applied to an arbitrator's determination of arbitrability.

In many of the cases which have been heard at futures, securities, and other arbitration forums, the arbitrators were presented by the parties with the question of

whether the dispute was arbitrable or whether the arbitration forum had jurisdiction over a party. It is unfair and wasteful to allow a party who unsuccessfully raises the issue of arbitrability before the arbitrators and thereafter participates in the entire arbitration proceeding (without seeking judicial relief or expressly reserving the right to do so) to subsequently reassert the arbitrability issue for *de novo* review by a court. This result is contrary to the national policy favoring arbitration in general and arbitration of securities and futures disputes in particular.

B. Failure to Apply a Deferential Standard of Review Could Encourage Litigation Over Arbitration Proceedings, Thereby Minimizing the Advantages of Arbitration, Increasing the Backlog in the Courts, and Depriving Some Claimants of a Forum for Resolving Their Disputes.

Although most arbitration forums do not keep statistics on the number of cases which involve arbitrability issues, our experience is that the numbers are significant. Obviously, it is much easier to overcome an arbitration award under a *de novo* standard of review than under a deferential standard of review. Therefore, the number of post-arbitration challenges to an arbitration award could increase substantially if the standard of review to be applied is *de novo* review rather than deferential review.

Arbitration is attractive because it tends to be quicker and less expensive than litigation. Anything that adds unnecessary length or costs to this process makes it less attractive and less cost-effective. As the number of post-arbitration challenges increases, so does the average length and expense of arbitration proceedings and the

probability that arbitration claims will end up in court. Claimants who believe that their claims will end up in court anyway because of a dispute over arbitrability are less likely to seek arbitration, with two possible results. Where the claim is large enough to justify the time and expense, some claimants may file their claims in court to begin with, thereby increasing the dockets and the backlog in the courts.[1] If these larger claims do end up in arbitration based on a pre-dispute agreement, the subsequent post-award litigation over arbitrability will have much the same effect on the backlog in an already overworked court system. Where the claim is for a smaller amount, as is typical for claims brought in securities and futures arbitration forums, claimants may simply decide to abandon their claims because those smaller claims cannot be pursued cost-effectively in any other forum. In either case, the result is inconsistent with the federal policy in favor of arbitration and the regulatory framework which promotes arbitration of claims in the securities and futures industries.

The claim in the underlying arbitration at issue here was for over $6,000,000, and the claimant in that case is a relatively large, well-capitalized firm which has the resources and the motivation to pursue its claim all the way to the U.S. Supreme Court. However, most arbitration claims are for much smaller amounts, and many

[1] *Amici* realize that most cases in the securities industry are governed by pre-dispute arbitration agreements. In the futures industry, however, a registrant may not require a customer to sign a pre-dispute agreement as a condition of doing business. 17 C.F.R. § 180.3 (1994). While some customers voluntarily sign these agreements, many do not.

involve claimants with limited resources. For example, of the 12,713 commercial arbitration cases filed with the AAA in 1993, 35% involved claims of $10,000 or less and 68% involved claims of $50,000 or less. Only 3% involved claims over $1,000,000. These smaller claims ($50,000 and under) took an average of 143 days (or 4.75 months) to resolve. Brief of American Arbitration Association as *Amicus Curiae* in Support of Petitioners, at Appendix, *Allied-Bruce Terminix Companies, Inc. v. Dobson*, 628 So. 2d 354 (Ala. 1993), *cert. granted*, ___ U.S. ___, 114 S. Ct. 1292 (1994) (No. 93-1001) (brief filed with the U.S. Supreme Court on May 18, 1994).

Statistics for the NFA and CBOT cases filed in the last two years show a similar concentration of smaller claims. In 1993, 52% of NFA's filings and 35% of the CBOT's filings involved claims of $10,000 or less; 72% of the cases filed at NFA and 45% of the cases filed at the CBOT involved claims of $50,000 or less; and 4% of the claims filed at NFA and 2% of the claims filed at the CBOT involved claims in excess of $1,000,000. For 1994, these numbers are 47% and 71%, respectively, for claims of $10,000 or less; 72% and 86% for claims of $50,000 or less; and 5% and 0 for claims over $1,000,000. Average turnaround times for claims of $50,000 or less during this same period ranged from a high of 7.75 months at NFA in 1994 to a low of 1.75 months at the CBOT in 1993. *Amici* are concerned that imposing a *de novo* standard of review on arbitrability issues will dramatically increase the time and expense required to resolve disputes through arbitration, effectively depriving customers with smaller claims of a forum for resolving their disputes.

IV. CONCLUSION

For all of these reasons, the Chicago Board of Trade, the Chicago Mercantile Exchange, and National Futures Association respectfully ask this Court to reverse the finding below and adopt the narrow holding that a court should apply a deferential standard of review to an arbitrator's decision concerning arbitrability if the parties had submitted that issue to the arbitrator for decision.

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No. 94-560

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1994

FIRST OPTIONS OF CHICAGO, INC.,

Petitioner,

vs.

MANUEL KAPLAN, CAROL KAPLAN AND M.K. INVESTMENTS, INC.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

BRIEF FOR AMICI CURIAE PHILADELPHIA STOCK EXCHANGE, INC., CHICAGO BOARD OPTIONS EXCHANGE, INC. AND PACIFIC STOCK EXCHANGE, INC. IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether a court reviewing an arbitration award under the Federal Arbitration Act should apply a de novo standard of review or the more deferential standard applied to arbitrators' decisions on the merits when reviewing the arbitrators' decision on arbitrability where the party objecting to arbitral jurisdiction had submitted the issue to the arbitrators for decision, as to which the courts of appeal are in conflict.

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No. 94-560

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STATEMENT OF INTEREST OF THE AMICI CURIAE

The Securities and Exchange Commission ("SEC"), pursuant to the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78a *et seq.*, has approved arbitration rules of the various self-regulatory organizations ("SROs") under the SEC's oversight.

Accordingly, the SROs have established SRO arbitration forums to resolve disputes between SRO members and between SRO members and their customers. Each

year thousands of disputes are fairly and efficiently resolved through binding SRO arbitrations that otherwise would clog state and federal court dockets, taxing not only judicial resources, but the parties' pocketbooks as well. The SRO securities arbitrations have been so effective that this Court has sounded a ringing endorsement of the program. *See Rodriguez De Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989). *See also Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

The Philadelphia Stock Exchange, Inc. ("PHLX"), Chicago Board Options Exchange, Inc., and Pacific Stock Exchange, Inc. are SROs registered with the SEC as national securities exchanges. The PHLX and other amici have established and maintained SRO arbitration programs. The amici have a significant and vital interest in the resolution of the issue in this case, specifically the standard of review to be applied to completed arbitrations.

In the instant case, the Third Circuit has dramatically undercut SRO arbitrators' ability to render final, binding arbitration decisions by allowing a court to re-examine *de novo* whether a dispute is arbitrable after the arbitrators have rendered a final decision regarding the merits of a dispute. This is especially disconcerting as the parties herein had participated in all aspects of the arbitration proceeding and had submitted the question of arbitral jurisdiction to the panel of arbitrators and did not in any manner reserve the question for determination by a court and/or seek immediate judicial intervention to review the arbitral jurisdiction issue. The Third Circuit's decision to subsequently review the jurisdiction issue *de novo* in

this case contravenes the clear federal policy in support of arbitration as a fair and efficient means of final and binding dispute resolution for those parties having submitted a dispute to arbitration.

If allowed to stand, the Third Circuit's decision in this case will inevitably have a deleterious impact on the SRO arbitration programs conducted by the amici. Initially, the Third Circuit's standard of *de novo* review will undercut the efficiency and certainty of binding SRO arbitration decisions. Ultimately, such *de novo* review will discourage willing participation by arbitrators as well as litigants in binding arbitration programs. The result will be that more securities disputes will be directed to the already overburdened courts.

SUMMARY OF ARGUMENT

Once parties have conferred on the arbitrators the authority to determine issues of arbitrability and, thereafter, have proceeded to the hearing on the merits before the arbitrators, the applicable standard of review of SRO arbitrators' decisions on arbitral jurisdiction should be the same standard accorded to the arbitrators' decisions on the merits of the dispute, namely deference. *See United Paperworkers Int'l Union, AFL-CIO v. Misco, Inc.*, 484 U.S. 29 (1987) (courts not authorized to challenge arbitrator's decision if arbitrator's authority drawn from essence of agreement). Essentially, this standard permits the courts to overturn the arbitrators' decisions only for a manifest disregard of the law (or as set forth in the applicable

statute). *See Nolde Brothers, Inc. v. Bakery Workers*, 430 U.S. 243 (1977). *See also Advest v. McCarthy*, 914 F.2d 6, 10 (1st Cir. 1990) (level of deference accorded arbitrator's selection of remedies greater than that accorded constitutional court); *Andros Compania Maritima v. Marc Rich and Co., A.G.*, 579 F.2d 691 (2d Cir. 1978) (even colorable justification for arbitrator's conclusion results in confirmation of award); *French v. Merrill, Lynch, Pierce, Fenner & Smith*, 784 F.2d 902 (9th Cir. 1986) (confirmation of award by court of appeals even if erroneous findings of fact and misrepresentation of law since agreement covers arbitrator's power to arbitrate).

This Court should resolve the split in the circuits by reaffirming the deferential standard, which provides that once an arbitration decision is rendered as to the merits of a dispute, all substantive decisions made by the arbitrators that led to the final decision on the merits, including any decision as to the arbitrability of the dispute, should receive, if appealed, deferential review by a court. This Court has held in numerous arbitration contexts that arbitrators' discretion in rendering final decisions is broad and that a court's interference with that discretion is inappropriate. This view is consistent with the policies underlying the Federal Arbitration Act, the federal securities laws' policy favoring arbitration of securities disputes, and this Court's own preference for securities dispute resolution through SEC approved and regulated SRO arbitration programs.

ARGUMENT

I.

THE THIRD CIRCUIT DECISION INAPPROPRIATELY UNDERMINES THE SECURITIES ARBITRATION SCHEME

The recent Third Circuit decision shocks basic contract law principles relating to whether parties have agreed to binding arbitration, and upsets the entire bedrock of the SRO securities arbitration scheme.

The amici urge this Court to reaffirm the deferential standard of judicial review of final arbitration awards. Once securities arbitrators have been permitted by the parties to render a final decision on the merits, a reviewing court must be deferential to the arbitrators' decision when reviewing any predicate decisions to that final decision, including any decision as to arbitrability of the dispute by the arbitrators. The corollary standard would be that if a party seeks to contest whether a matter is arbitrable or whether such party is subject to an agreement to arbitrate, that party must immediately seek a judicial determination as to such issue[s] and/or expressly reserve such right prior to a final decision by the arbitrators on the merits of the dispute. Failure to take such actions would constitute a *per se* waiver or estoppel of any right by any party to *de novo* court review of the issue of arbitrability. *See Teamsters Local Union v. J.H. Merritt & Co.*, 770 F.2d 40, 42-43 (3d Cir. 1985). *See also Interstate Brands Corp. v. Chauffers, Teamsters, Warehousmen & Helpers, Local Union No. 135*, 909 F.2d 886 (6th Cir. 1990), cert. denied, 499 U.S. 905 (1991) (if neither party objects to arbitrability decision of arbitrator, parties

deemed to implicitly agree to arbitration); *Piggly Wiggly Operators Warehouse Inc. v. Piggly Wiggly Operators Warehouse Independent Truck Driver's Union*, 611 F.2d 580 (5th Cir. 1980) (grievance submitted to arbitrator defines authority without regard to prior legal obligation to submit dispute).

However, in this and a series of other cases, the Third Circuit has reasoned that it was enough for a party to merely object to whether a dispute is arbitrable. These courts conclude that even if a party proceeds with costly, time-consuming proceedings to a final decision by the arbitrators on the merits of the dispute, the objecting party has not waived the right to a judicial determination of the arbitrability issue, and the reviewing court may even conduct a full *de novo* review of the issue of arbitrability, which can totally undermine the entire completed proceeding. *See Pennsylvania Power Co. v. Local Union No. 272*, 886 F.2d 46, 51 (3d Cir. 1989). *See also Local 719, American Bakery & Confectionery Workers of America, AFL-CIO v. The National Biscuit Company*, 378 F.2d 918, 921 (3d Cir. 1967).

De novo review with regard to the issue of arbitrability undermines the efficacy of the entire arbitration process when, as in the instant case, the parties have appeared before the arbitrators, participated in preliminary hearing conferences, conferred the power and authority on the arbitrators with respect to the resolution of the issue of jurisdiction/arbitrability, and thereafter proceeded and allowed the arbitrators to render a final decision on the dispute's merits.

On July 24, 1989, the Respondents in this case filed with the PHLX arbitrators a substantial counterclaim and an answer to the statement of claim filed by Petitioner, who was the arbitration Claimant. Respondents' answer denied liability and objected to the PHLX's arbitral jurisdiction. This jurisdictional objection was orally withdrawn by Respondents' counsel of record during a preliminary hearing held on February 26, 1990. That being the case, the PHLX arbitrators and Petitioner were justifiably led to believe that the arbitrability question was no longer an issue. Not until January 6, 1992, through Respondents' newly retained counsel, did the arbitrability issue again arise via a Motion to Dismiss for Lack of Jurisdiction ("Motion"). On January 10, 1992, the arbitrators denied Respondents' Motion. Petitioner reasonably relied on these actions and concluded that the arbitrators' determination with regard to jurisdiction was final, in that Respondents in no manner again raised and/or reserved the arbitrability objection during the remainder of the proceeding, including during the eight days of hearing sessions that were conducted on the merits of the case.

Under the aforementioned circumstances, the Third Circuit's invocation of *de novo* review of whether the arbitrators possessed arbitral jurisdiction over the parties in this arbitration is inappropriate for many reasons. First, a standard of *de novo* review in this particular case creates substantial unfairness. The standard of allowing parties who lose in arbitration to defer judicial review of the arbitrators' decision on arbitral jurisdiction enables such arbitration parties to retain their jurisdictional argument as insurance, while attempting first to prevail on

the merits. If a party prevails on the merits, then no appeal is taken. On the other hand, if the party loses, he or she would have every incentive to revive his or her jurisdictional challenge and request the court to overturn the arbitration award through a *de novo* review regarding whether the matter was arbitrable in the first instance. Hence, the objecting party is unfairly allowed to hold an "ace in the hole" while the opposing party is required to play all its cards.

Second, significant resources are utterly wasted when an arbitration award is reversed by a court's "second guessing" of arbitral jurisdiction after the entire arbitration has run its course. In this arbitration case alone, thousands of hours were expended by the Exchange arbitration administrators, arbitrators, witnesses and the parties themselves, all to no ultimate avail in the effort to create a final, binding resolution of the dispute. Those thousands of hours reflect hundreds of thousands of dollars in time and effort wasted. According to the Third Circuit, this case must now be relitigated in court all over again. Affording deference to the arbitrators' award, including the decision on the arbitrability of the dispute, would have appropriately assured binding finality to this case. This is especially true since the Respondents had submitted the question of jurisdiction to the arbitrators, had failed to reserve the question of judicial review (that action constituting a waiver of objections to the arbitrators' jurisdiction) and thereafter had proceeded on the merits to the conclusion of the matter. At no time had Respondents reserved or sought judicial review with regard to the arbitrators' decision on jurisdiction prior to the arbitrators' decision on the merits.

The deferential standard is the only standard of review that is consonant with the strong federal policies favoring the resolution of disputes through binding arbitration and this Court's previous support of securities arbitration. *See United Steelworkers of America v. American Manufacturing Company*, 363 U.S. 564 (1960). *See also Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

Third, basic contract principles mandate a deferential standard of review of decisions regarding arbitrability. In this regard, the Third Circuit disregarded basic contract law when it decided that parties do not expressly or by implication waive their right to *de novo* judicial review of the arbitrability issue when they merely object to jurisdiction, yet present the issue of jurisdiction to the arbitrators and then pursue to conclusion costly and time-consuming proceedings on the merits of the dispute. *See* Restatement Second of Contracts § 84 (1981). *See also Reiter v. Yellowstone County, Montana et al.*, 627 P.2d 845, 850 (1981) (defined implied waiver as detrimental reliance). Moreover, by not finding such a waiver, the Third Circuit ignored principles of estoppel and good faith and fair dealing. All parties spent considerable time and money on the arbitration proceedings and relied to their detriment on the objecting parties' "good faith" participation in these proceedings. *See* Restatement Second of Contracts §§ 34, 84, 90 and 205 (1981). *See also Neverett v. Towne*, 159 A.2d 345, 351 (1960) (defendant subject to estoppel where plaintiff detrimentally relied on defendant's misrepresentation).

Finally, the Third Circuit decision places a chilling effect on the arbitral process by encouraging SRO arbitrators to

either refuse to accept or to readily dismiss matters involving jurisdictional objections as submitted for resolution to them by the parties. The practical result is an increase in both state and federal court dockets and a delay in the processing of securities disputes, which runs afoul of the federal policies favoring fair, efficient and speedy resolution of these cases through arbitration.

CONCLUSION

For the aforementioned reasons, the amici respectfully request this Court to reverse the Third Circuit's decision on the standard of review and re-establish a uniform, nationwide standard of deferential review of arbitrators' decisions on the issue of arbitrability. The deferential standard is particularly compelling when, as in this case, the objecting party freely submitted the issue to the arbitrators for a determination without reservation. We look for this Court to once again restore the SRO arbitration fora to their original and intended purpose - swift, just, effective and consistent securities dispute resolution.

Respectfully submitted,

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No. 94-560

In the
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OCTOBER TERM, 1994

FIRST OPTIONS OF CHICAGO, INC.,
PETITIONER,

v.

MANUEL KAPLAN, CAROL KAPLAN
AND M.K. INVESTMENTS, INC.,
RESPONDENTS.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

BRIEF OF THE SECURITIES INDUSTRY ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

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In the
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OCTOBER TERM, 1994

No. 560

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v.

MANUEL KAPLAN, CAROL KAPLAN
AND M.K. INVESTMENTS, INC.,
RESPONDENTS.

**ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT**

BRIEF OF THE SECURITIES INDUSTRY ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

STATEMENT OF INTEREST OF THE AMICUS CURIAE

The Securities Industry Association ("SIA") is the principal trade association of the securities industry, with more than 750 member firms in the United States and Canada. As a member of the Securities Industry Conference on Arbitration, the SIA has been intimately involved in the evolution of the arbitration process. The SIA and its members, which now use arbitration to resolve over five thousand claims annually, have a significant interest in ensuring that the process provides a

mechanism for resolving disputes quickly, efficiently, economically and fairly.

The SIA has participated as *amicus curiae* in several cases, including *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. 213 (1985), and *Rodriguez de Quijas* v. *Shearson/American Express, Inc.*, 490 U.S. 477 (1989), arguing successfully that the courts should require parties to honor pre-dispute agreements to arbitrate a specified claim or category of claims. It also has submitted an *amicus curiae* brief in *Mastrobuono* v. *Shearson Lehman Hutton, Inc.*, No. 94-18, arguing that where the parties to an arbitration agreement explicitly chose to incorporate the law of a state which does not permit arbitrators to award punitive damages, the courts should enforce their contract and vacate any punitive damage award issued by the arbitrators. The principle guiding the SIA in these and similar cases is that which underpins the Federal Arbitration Act: the agreement of the parties should be enforced according to its terms.

The same principle is implicated in this case. The SIA believes it is important to the legitimacy of the arbitral system that the courts be available to determine whether the arbitrators have acted within the bounds of the power provided to them by the parties. By assuring adherence to the terms of the arbitration agreement, the availability of *de novo* judicial review fosters use of arbitral processes. The SIA's member firms thus have a substantial interest in the continued availability of post-award review of the scope of the arbitrators' authority.

The parties have consented to the filing of this amicus curiae brief.

SUMMARY OF ARGUMENT

In ruling on a motion to vacate under Section 10(a)(4) of the Federal Arbitration Act, 9 U.S.C. §§ 1-16, a federal district court should not defer to the arbitrators' conclusions concerning the scope of their power, unless the parties have clearly and unmistakably agreed to be bound by the arbitrators' determination.[1] Absent such agreement, the question of the scope of the arbitrators' authority remains the responsibility of the courts, whether it arises prior to arbitration in the context of a motion to compel arbitration under Section 4 of the Act or in a motion to vacate under Section 10 of the Act.

The assurance, absent contrary agreement, of plenary judicial review of the scope of the arbitrators' authority encourages parties to submit issues to arbitration. Truncating post-award review of the arbitrators' authority would force increased resort to the courts prior to arbitration in cases which otherwise may well be resolved without judicial intervention.

Accordingly, the Court should rule that the Court of Appeals properly did not defer to the arbitrators on the question of their power, once it had determined that the parties had not agreed that the arbitrators were to determine their own authority.

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[1] The SIA takes no position on whether such a clear and unmistakable agreement existed here.

ARGUMENT

THE COURT OF APPEALS PROPERLY RULED THAT THE ARBITRABILITY OF THE DISPUTE WAS SUBJECT TO DE NOVO JUDICIAL REVIEW ON A MOTION TO VACATE.

In ruling on the individual Respondents' motion to vacate the arbitration award under Section 10(a)(4) of the Federal Arbitration Act, the Court of Appeals did not defer to the arbitrators' conclusion that the individual Respondents were obligated to arbitrate their dispute with Petitioner. Since it found that the individual Respondents had not "clearly indicated [their] willingness to forego judicial review" of the arbitrability of the dispute, the Court of Appeals properly concluded that review of the question of the arbitrators' authority should be *de novo*. App. A-21.

The SIA is not addressing the Court of Appeals conclusion that the individual Respondents did not waive judicial review of the arbitrators' authority.[2] Rather, the issue of importance to the SIA is the standard of judicial review of the arbitrators' authority, assuming that an objection to the arbitrators' jurisdiction is properly preserved.

A. The question of whether the parties agreed to arbitrate is to be decided by the court, unless the parties "clearly and unmistakably" provide otherwise.

Under the Federal Arbitration Act, the determination of the arbitrability of a dispute, including whether an arbitration agreement exists or is applicable, is for the courts to make, absent contrary agreement. *See Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403-04 (1967) (stating that under the Federal Arbitration Act the question of fraud

[2] The SIA also is not addressing the question of whether the Court of Appeals applied the appropriate scope of appellate review.

in inducement of the agreement to arbitrate is for judicial determination). In the context of labor arbitrations, this Court has held:

> [T]he question of arbitrability . . . is undeniably an issue for judicial determination. ***Unless the parties clearly and unmistakably provide otherwise***, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator.

AT&T Technologies, Inc. v. *Communications Workers of America*, 475 U.S. 643, 649 (1986) (emphasis added); *see also Wiley & Sons, Inc.* v. *Livingston*, 376 U.S. 543, 546-47 (1964) ("'Under our decisions, whether or not the company was bound to arbitrate, as well as what issues it must arbitrate, is a matter to be determined by the Court on the basis of the contract entered into by the parties.'") (citations omitted).

This Court's reasoning in the context of labor arbitration is equally applicable in commercial arbitrations. "The willingness of the parties to enter into agreements that provide for the arbitration of specified disputes would be 'drastically reduced,' . . . if a labor arbitrator had the 'power to determine his own jurisdiction. . . .'" *AT&T Technologies*, 475 U.S. at 651 (citations omitted).

Moreover, the provisions of the Federal Arbitration Act manifest a clear policy that the authority of the arbitrators is to be determined by the courts. Section 4 of the Act allows a party aggrieved by the refusal of another to arbitrate to bring a motion to compel arbitration. In a proceeding under Section 4, the question of the making of an arbitration agreement is explicitly assigned to the judiciary. *See Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985). Similarly, Section 10 of the Act, discussed more fully below, provides that a district court may vacate an arbitration award, "Where the arbitrators exceeded their powers. . . ."

B. Section 10(a)(4)'s authorization of vacatur where an award exceeds the arbitrators' powers encompasses the authority to vacate an award where there is no agreement to arbitrate.

Section 10(a)(4) of the Federal Arbitration Act authorizes a court to vacate an award that exceeds the authority of the arbitrators. An arbitral award where a party has not agreed to arbitrate is, without doubt, beyond the arbitrator's authority. As this Court has emphasized, "[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." *United Steelworkers of America* v. *Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960); *see also Volt Information Sciences, Inc.* v. *Board of Trustees*, 489 U.S. 468, 479 (1989) ("Arbitration under the Act is a matter of consent, not coercion. . . .").

The Court of Appeals in this case concluded that the individual Respondents had not "clearly indicated [their] willingness to forego judicial review" of their objections to the arbitrators' jurisdiction. App. A-21 (citation omitted). Based on this conclusion, the Court of Appeals properly determined that the question of the existence of an agreement to arbitrate, raised by the motion to vacate under Section 10(a)(4), was subject to judicial review.

The logic of the Court of Appeals here is fully consistent with that of other appellate courts which have discussed the question. For example, in *Davis* v. *Chevy Chase Fin. Ltd.*, 667 F.2d 160 (D.C. Cir. 1981), the Court of Appeals held that an arbitrator's award should be vacated under Section 10(d) of the Act (later renumbered Section 10(a)(4)) because he had exceeded his powers by deciding issues beyond those assigned to him by agreement. The Court reasoned that, "[A]n arbitral award regarding a matter not within the scope of the governing arbitration clause is one made in excess of authority,

and a court is precluded from giving effect to such award." *Id.* at 165; *see Humphrey* v. *Prudential Securities Inc.*, 4 F.3d 313, 319 (4th Cir. 1993) (stating that issue of whether "arbitrators exceeded the scope of arbitration agreed to by the parties by reviewing [plaintiff's] claims" may be raised on motion to vacate an award). Indeed, case law upon which Petitioner relies states that an objection to the jurisdiction of an arbitrator, if properly preserved, is subject to judicial review on a motion to vacate the arbitration award. *See George Day Constr. Co.* v. *United Bhd. of Carpenters, Local 354*, 722 F.2d 1471, 1476 (9th Cir. 1984) ("the employer merely had to voice its objection on the arbitrability issue and state on the record that it was reserving that question for later judicial determination. In this way, the question could be preserved for *independent judicial scrutiny* at any subsequent proceeding for vacatur or enforcement.") (emphasis added); *Van Waters & Rogers Inc.* v. *International Bhd. of Teamsters, Local Union 70*, 913 F.2d 736, 740 (9th Cir. 1990) (finding that the issue of arbitrability had been properly reserved under *George Day* and accordingly was subject to judicial review).

Allowing an arbitral award to be challenged under Section 10(a)(4) on the grounds that there is no agreement to arbitrate is, moreover, directly analogous to other challenges which courts have permitted pursuant to that provision. For example, under Section 10(a)(4) courts have accepted challenges to arbitrators' authority to determine particular issues[3] and to award particular forms of relief.[4] We are aware

[3] *See, e.g., Edward D. Jones* v. *Sorrells & Co.*, 957 F.2d 509, 512 (7th Cir. 1992) (affirming grant of motion to vacate under Section 10(d) of the Federal Arbitration Act where certain claims were ineligible for arbitration).

[4] *See, e.g., Delta Queen Steamboat Co.* v. *District 2 Marine Engineers Beneficial Ass'n.*, 889 F.2d 599, 602 (5th Cir. 1989) (referencing Section 10(d) of the Federal Arbitration Act and vacating arbitration decision where remedy ordered by arbitrator was beyond his authority under the agreement) and cases cited, *cert. denied*, 498 U.S. 853 (1990).

of no appellate opinion holding that the existence of an agreement to arbitrate is not subject to judicial review under Section 10(a)(4), other than where the parties have clearly and unmistakably agreed that the arbitrators could decide their own jurisdiction.[5] *But cf. Comprehensive Accounting Corp.* v. *Rudell*, 760 F.2d 138, 141 (7th Cir. 1985) (declining to decide whether the validity of an agreement to arbitrate might be litigated in a confirmation proceeding).

Post-award judicial review of the existence of an arbitration agreement is supported not only by the language of Section 10(a)(4) but also by the presumption that issues of arbitrability are to be decided by the courts, not the arbitrators. The absence of a provision in the Act allowing a party resisting arbitration to seek a court-ordered stay of proceedings indicates that Section 10(a)(4) was intended to allow a post-award judicial determination.[6]

In addition, post-award judicial review of the arbitrability question furthers the Congressional policy expressed in the Federal Arbitration Act: "to make arbitration agreements as enforceable as other contracts *but not more so.*" *Prima Paint*,

[5] The fact that a party opposing arbitration may be able to provoke the proponent of arbitration into moving to compel does not mean that post-award judicial review of the existence of an arbitration agreement should be unavailable under Section 10(a)(4). Even though one party objects to arbitration, both parties may be content to defer a judicial determination of arbitrability. This is particularly the case where multiple parties are involved or arbitrable and non-arbitrable issues are involved.

Nevertheless, the ability of the proponent of arbitration to secure a pre-arbitration judicial determination of arbitrability is significant. It means that only if the proponent of arbitration *elects* not to secure a judicial determination of arbitrability by means of a motion to compel does it proceed through arbitration without knowing if the dispute will be held to be arbitrable.

[6] A party who believes that it is not obligated to arbitrate a dispute or that certain issues are not arbitrable may seek to enjoin the arbitration. That remedy, however, is not one arising under the Federal Arbitration Act and should not reflect on the scope of appropriate review under Section 10(a)(4).

388 U.S. at 404 n.12 (emphasis added). Judicial scrutiny of arbitrability encourages the use of arbitration by assuring the parties that their agreement to arbitrate will be honored according to its terms. *See AT&T Technologies*, 475 U.S. at 643.

Finally, recognizing that Section 10(a)(4) may be used to secure a judicial determination of whether an agreement to arbitrate exists also harmonizes federal law with the Uniform Arbitration Act, in force in the majority of state jurisdictions. That Act explicitly provides in Section 12 that:

> Upon application of a party, the court shall vacate an award where:
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> • • •
>
> (5) There was no arbitration agreement and the issue was not adversely determined in proceedings under Section 2 [governing motions to compel and to stay] and the party did not participate in the arbitration hearing without raising the objection;

7 U.L.A. 140 (1955). Reading Section 10(a)(4) to allow post-award challenges to an arbitrator's authority thus avoids generating opportunities for forum shopping.

C. Unless the parties have clearly and unmistakably agreed to be bound by the arbitrators' determination of their own authority, a court's review of arbitrability under Section 10(a)(4) is *de novo* and a decision by the arbitrators that the dispute is arbitrable is not entitled to deference.

Arbitrators may, on their own initiative or at the request of a party, rule on the question of arbitrability of a dispute. As long as the party resisting arbitration does not consent to

its resolution by the arbitrators,[7] the arbitrators' decision on arbitrability should not be accorded the deference given to a decision on the merits. The Court of Appeals here observed, "An arbitrator's decision to assert jurisdiction over objection is . . . subject 'to a much broader and more vigorous judicial review' than an arbitral decision on the merits. Because it is 'a question for the court to decide,' it is subject to *de novo* judicial review." App. A-22-23 (quoting *International Bhd. of Teamsters, Local 249* v. *Western Pennsylvania Motor Carriers Assn.*, 574 F.2d 783, 787 (3d Cir. 1978), *cert. denied*, 439 U.S. 828 (1978)); *see also International Ass'n. of Machinists, Lodge No. 1777* v. *Fansteel, Inc.*, 900 F.2d 1005, 1010 (7th Cir. 1990) ("While we note that the arbitrator attempted to decide the arbitrability question, the resolution of this question is our responsibility and we will approach this issue *de novo* without deference to the arbitrator's decision."), *cert. denied*, 498 U.S. 851 (1990); *Davis*, 667 F.2d at 167 (rejecting argument that "an agreement to arbitrate an issue carries with it a concomitant power to determine arbitrability with limited judicial review") Judicial review of merits decisions is sharply restricted in order to further the parties' choice to have the dispute resolved by arbitrators, not the courts. *United Papermakers Int'l Union* v. *Misco, Inc.*, 484 U.S. 29, 36-38 (1987).

A decision concerning the arbitrator's authority to resolve a particular dispute is altogether different. As with questions about whether a specific issue is within the scope of the arbitration agreement or whether the arbitrator has authority to utilize a particular remedy, the question of arbitrability goes to the legitimacy of the dispute-resolution process. That legitimacy stems from the contract between the parties.

[7] Participating in an arbitration without seeking injunctive relief should not be construed as "clear and unmistakable" agreement to allow the arbitrators to determine arbitrability. Such a requirement would force a party who believes that a dispute in whole or part is not arbitrable to seek judicial intervention. Since the arbitration process may eliminate or narrow the questions which the courts need to address, forcing pre-arbitration resort to the courts may be in the interest of neither the parties nor the judiciary.

Further, truncating post-award review of arbitrability, or other questions of the arbitrators' authority, would have undesirable consequences. Parties wishing to preserve their position that a dispute was not arbitrable would be forced to seek to enjoin the arbitration proceedings before they occurred, increasing the demand on judicial resources and the expense to the litigants.[8] *See Fansteel*, 900 F.2d at 1009 ("in permitting an arbitrator to attempt to address a dispute prior to judicial arbitrability determination, parties may well be able to resolve their disputes without requiring the involvement of the judiciary."); *Davis*, 667 F.2d at 168 (limiting post-award review of arbitrability "might actually *foster* litigation by requiring parties to seek 'interlocutory' review of jurisdictional rulings"). To the extent that post-arbitration relief were unavailable, parties would be discouraged from entering into agreements to arbitrate specified disputes by the knowledge that the arbitrators might exercise jurisdiction more broadly than intended. *AT&T Technologies*, 475 U.S. at 651.

Conclusion

Having determined that the parties did not agree that the arbitrators could determine their own jurisdiction, the Court of Appeals properly ruled that the arbitrators' conclusion on arbitrability was not entitled to deference and that *de novo* judicial review of the existence of an arbitration agreement was appropriate pursuant to the individual Respondents' motion to vacate under Section 10(a)(4) of the Federal Arbitration Act. We urge that the Court follow the reasoning of the Court of Appeals in this regard in order to facilitate the

[8] In multi-party cases such as this one, pre-arbitration judicial proceedings may well slow the arbitration process by causing the resolution of admittedly arbitrable disputes or issues to be deferred pending the judicial ruling. Experience, including that under the Uniform Arbitration Act, does not suggest that post-award judicial review of arbitrability has negatively affected the arbitration process.

effective enforcement of agreements to arbitrate by their terms, as Congress intended.

Respectfully submitted.

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